



Reserve Bank
of New Zealand
Te Pūtea Matua

2025 Review of key capital settings

Policy proposals for feedback

25 August 2025

CONSULTATION
PAPER



Submission details

The Reserve Bank of New Zealand – Te Pūtea Matua invites submissions on this Consultation Paper by 5.00pm on 3 October 2025.

Please note the disclosure on the publication of submissions below.

Submissions and enquiries

Please email your submissions and enquiries to capitalreview@rbnz.govt.nz.

Publication of submissions

We will publish your submission on the Reserve Bank's website.

We will make all information in submissions public unless you indicate you would like all or part of your submission to remain confidential. Please refer to our policies on how we store and may share your information - [Reserve Bank website privacy policy](#) and the [Consultation privacy information](#). If you would like part of your submission to remain confidential you should provide both a confidential and a public version of your submission. Apart from redactions of the information to be withheld (that is, the blacking out of text) the two versions should be identical. You should ensure that redacted information is not able to be recovered electronically from the document; the redacted version will be published as received.

If you want all or part of your submission to be treated as confidential, you should provide reasons why this information should be withheld if a request is made for it under the Official Information Act 1982 (**OIA**). These reasons should refer to the grounds for withholding information under the OIA. If an OIA request for redacted information is made, we will make our own assessment of what must be released taking your views into account.

To aid the writing of their independent reports, your submissions will also be provided to the independent international experts (Thorsten Beck, Elena Carletti and Sir John Vickers) ahead of publication. We may also publish an anonymised summary of the submissions received in response to this Consultation Paper.

Navigating this document

Purpose of this document

We are reviewing our key capital settings to assess whether the Reserve Bank's prudential capital requirements for deposit takers are set at the appropriate level to support a stable financial system – one where resilient financial markets, institutions and infrastructures enable a productive and sustainable economy and ultimately promote the prosperity and well-being of all New Zealanders.

This Consultation Paper plays an important role to enable us to hear feedback on our proposals. This ensures that our analysis is evidenced and sound.

We have engaged three independent international experts to provide challenge by reviewing our analysis, options and recommendations. However, views expressed in this document are those of the Reserve Bank. The views of the independent experts will be expressed in reports that they will produce following this consultation. The reports will be published at the end of the Review.

How to read this document

The document begins with an Executive Summary, followed by an Introduction (**Chapter 1**) which provides the background to the Review of key capital settings (the **Review**). This explains the purpose of capital, the decisions from the previous Capital Review in 2019, and the role of risk appetite in setting capital. The document is then split into chapters, each focusing on a different area.

- **Chapter 2** sets out how the context has changed since the previous review, including the passage of the Deposit Takers Act 2023 (**DTA**), the issuing of the new financial policy remit, feedback from recent inquiries, how our capital settings compare internationally and how changes impact risk.
- **Chapter 3** seeks feedback on two policy options for different capital requirements for deposit takers and explains our analysis of these options.
- **Chapter 4** sets out our proposal to replace Additional Tier 1 capital with more simple forms of capital to simplify the capital stack.
- **Chapter 5** sets out proposals for more granular standardised risk weights.

Following Chapter 5, the document contains a conclusion to this Consultation Paper that summarises the next steps in the Review.

This document has annexes to support your reading of the main chapters:

- **Annex A** contains a glossary of technical terms.
- **Annex B** contains a consolidated list of all the questions in this document.
- **Annex C** states the purposes and principles of the DTA.
- **Annex D** is an assessment of changes in the macroeconomic risk environment.
- **Annex E** presents further details of our cost benefit analysis.

To aid your understanding of matters in this document, we have also published:

- *Deposit Takers Core Standards: Summary of Submissions and Policy Decisions for the Capital Standard*.¹ This summarises the submissions that we received in response to the capital section of the DTA Core Standards Consultation Paper published in 2023. It includes policy decisions in some technical areas we do not expect to change as a result of this Review, whereas in other areas, decisions will instead be made following this consultation.
- *Key Questions and Answers: 2025 Review of key capital settings*² that focuses on key information you need to know.
- *Comparing New Zealand Bank Capital Ratios to International Peers*.³ This is a report we commissioned from an independent consultancy, Oliver Wyman, to benchmark the capital ratios for New Zealand's five largest registered banks against major banks in a set of comparator countries.

1 Reserve Bank of New Zealand. (2025). *Deposit Takers Core Standards: Summary of Submissions and Policy Decisions for the Capital Standard*. https://consultations.rbnz.govt.nz/dta-and-dcs/deposit-takers-core-standards/user_uploads/summary-of-submissions-policy-decisions-capital-standard.pdf

2 Reserve Bank of New Zealand. (2025). *Key Questions and Answers: 2025 Review of key capital settings*. https://consultations.rbnz.govt.nz/prudential-policy/review-of-key-capital-settings/user_uploads/key-questions-and-answers.pdf

3 Oliver Wyman. (2025). *Comparing New Zealand Bank Capital Ratios To International Peers*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/capital-review/2025/oliver-wyman-rbnz-capital-review.pdf>

Contents

Submission details	1
Navigating this document	2
Executive summary	5
1 Introduction	10
1.1 What is the purpose and scope of this Review?	10
1.2 What is capital?	12
1.3 How are we reviewing our capital settings?	16
1.4 What is the appropriate risk appetite for capital settings in New Zealand?	18
2 Context	21
2.1 Legislative changes since 2019	21
2.2 New evidence	29
2.3 International context	37
3 Capital stack options	45
3.1 Options for Group 1	45
3.2 Proposal for Group 2	49
3.3 Proposal for Group 3	50
3.4 Proposals for the counter-cyclical capital buffer	51
3.5 Assessment of options	52
3.6 Summary of cost benefit analysis	63
4 Additional Tier 1	65
4.1 Background	65
4.2 Proposal to remove AT1 capital	68
5 Standardised risk weights	72
5.1 Background	72
5.2 Proposal for more granular standardised risk weights	74
5.3 Community housing providers, co-operatives and whenua Māori risk weights (standardised and IRB)	90
6 Conclusion and next steps	100
6.1 Conclusion	100
6.2 Next steps	100
Annex A: Glossary	101
Annex B: Consolidated consultation questions	111
Annex C: DTA purposes and principles	116
Annex D: Assessment of changes in the macroeconomic risk environment	118
Annex E: Cost benefit analysis	120

Executive summary

Background

A stable financial system supports economic prosperity. Banking – or deposit taking as we refer to it in this Consultation Paper – is a large and leveraged sector that households and businesses must have confidence in to spend and invest. Periods of financial instability can cause direct costs and on-going scarring to the economy.

Capital requirements need to be set at the right level to balance the costs and benefits.

Capital requirements specify the minimum investment that owners of deposit takers must make in their business. Capital requirements that are too low risk deposit takers being unable to absorb unexpected losses when they arise and therefore failing – ultimately reducing the long-run prosperity and well-being of New Zealanders. Conversely, capital levels that are too high can reduce credit availability and increase costs unnecessarily.

In 2019, we completed a multi-year review of New Zealand’s capital framework (‘the 2019 Capital Review’). This resulted in the decision to significantly increase the quantity and improve the quality of capital that banks are required to operate with by 2028, to improve the resilience of the banking system.⁴ At the time, we made the judgement that we should focus on simple, but conservative, capital requirements for deposit takers to support stability. We focused on capital settings that would provide enough capital in the system as whole to cover losses that might only occur very infrequently – for example once in every 200 years.

Six years on, we are in the process of moving to a new suite of prudential standards under the Deposit Takers Act 2023 (DTA).⁵ As well as operating under this updated legislative framework, a new Financial Policy Remit (FPR) was issued in 2024, which places a greater focus on efficiency and competition.⁶ Further, submitters to recent inquiries have expressed concerns that our bank capital settings may be unreasonably conservative – undermining competition and development of the New Zealand economy. As a good financial system steward, it is important we consider recent developments and any new evidence presented as part of recent inquiries.

Therefore, earlier this year we announced a targeted review to test whether we have got our capital settings right.⁷ We want capital settings that support a stable financial system which enables a productive and sustainable economy and ultimately promote the prosperity and well-being of all New Zealanders.

Approach to this Review

Figure 1 below illustrates our analytical approach to this Review. First, we have considered changes to the context since the 2019 Capital Review. This is summarised in Chapter 2 of this Consultation Paper. Second, we have considered the appropriate *amount*, *form* and *distribution* of

4 Reserve Bank of New Zealand. (2025). *2017-2019 Capital Review*. <https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/how-we-regulate-and-supervise-banks/our-policy-work-for-bank-oversight/capital-review>

5 Reserve Bank of New Zealand. (2025). *Deposit Takers Act*. <https://www.rbnz.govt.nz/regulation-and-supervision/deposit-takers-act>

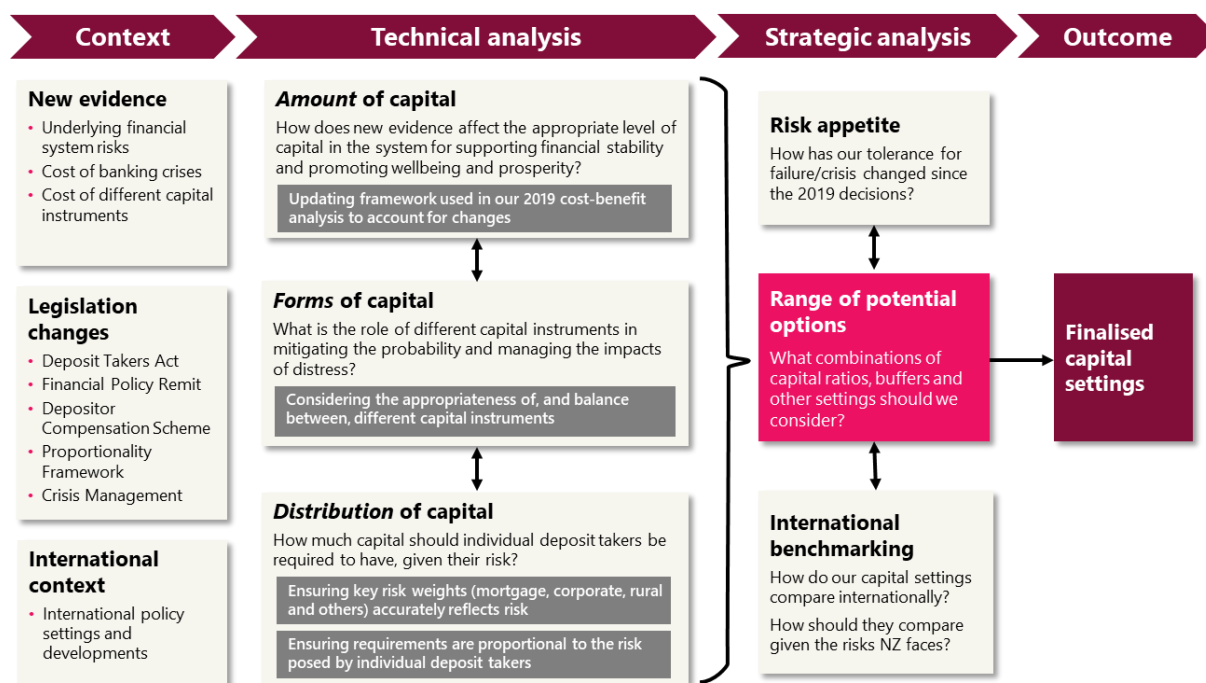
6 Reserve Bank of New Zealand. (2024). *Our Financial Policy Remit*. <https://www.rbnz.govt.nz/about-us/corporate-publications/our-financial-policy-remit>

7 Reserve Bank of New Zealand. (2025). *2025 Review of key capital settings: Terms of Reference*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/capital-review/2025/2025-review-of-key-capital-settings-terms-of-reference.pdf>

capital for New Zealand. This covers a range of interrelated topics that we cover throughout the remainder of this Consultation Paper, including:

- **Updated cost benefit analysis:** This is largely to inform the *amount* of capital that would be appropriate for New Zealand, and is covered in Chapter 3 and Annex E. Given the targeted nature of the Review – to avoid unnecessary delays to the implementation of the DTA – we have built on the analysis conducted in 2019 and are seeking feedback on that analysis through this consultation.
- **The role of Loss-Absorbing Capacity (LAC):** This informs the appropriate *form* of capital for the largest deposit takers and is closely related to our future approach to crisis management. It is covered in Chapter 3.
- **Applying proportionality:** This informs the *distribution* of capital in the system. We summarise our proposed options across different groups of deposit takers in Chapter 3.
- **The role of Additional Tier 1 (AT1) capital:** This informs the appropriate *form* of capital and is covered in Chapter 4.
- **Reviewing key risk weights:** This informs the *distribution* of capital in the system. It is covered in Chapter 5.

Figure 1: Analytical approach to the Review of key capital settings



Proposals in this Consultation Paper

This Consultation Paper seeks feedback on options calibrated to a higher risk appetite than in 2019. Under the Reserve Bank of New Zealand Act 2021, the Reserve Bank now has a Board which is responsible for determining the risk appetite for various regulatory outcomes – including capital settings. A key reason for the change in risk appetite is that under the DTA (once fully implemented) we will have more comprehensive tools for supervision and crisis management.

We have moved away from a “1-in-X year event” basis for our risk appetite and instead have focused on benchmarking against a range of comparator countries. We commissioned an independent external study to compare our capital settings with other countries – given the complexities in comparing different rules – to help assess how conservative we are in relative terms. This found that current levels of Tier 1 capital in New Zealand are likely one of the highest among our comparator countries. However, it also found New Zealand has lower Total Loss-Absorbing Capacity (TLAC) than many comparator countries.

In this Consultation Paper, we propose two specific changes to our capital framework which should improve the efficiency of our settings.

- **We propose simplifying the capital stack by removing AT1 capital,** which industry has previously raised concerns about (see Chapter 4).
- **We propose introducing more granular standardised risk weights,** including lower risk weights in some areas, to better align requirements with actual risk. This includes new risk weight categories for agricultural lending (see Table 1 below and Chapter 5). This change reduces the amount of capital that deposit takers are required to hold by around 5% across the system.

Table 1: Proposed changes for standardised risk weights

Type of lending	Current standardised risk weight (%)	Proposed standardised risk weight (%)
Owner-occupier residential mortgage lending (RML) with loan-to-value ratio (LVR) ≤50	35	25
Owner-occupier RML with LVR 50.01 – 60	35	30
Investor RML with LVR ≤50	40	30
Investor RML with LVR 50.01 – 60	40	35
Small and medium enterprise (SME) retail	100	75
SME corporate	100	85
Agriculture with LVR ≤30	100	50
Agriculture with LVR 30.01 – 50	100	75
Community housing providers / housing co-operatives	New standardised category with the same risk weights as investor RML. IRB accredited deposit takers would be required to use the new standardised category.	

We also set out two options for capital ratio requirements (see Table 2 below). They promote financial system stability and the safety and soundness of individual deposit takers but are likely to reduce the cost of regulation compared to the 2019 framework. The options take different approaches to the form of capital, with Option 2 introducing LAC for Group 1 deposit takers.

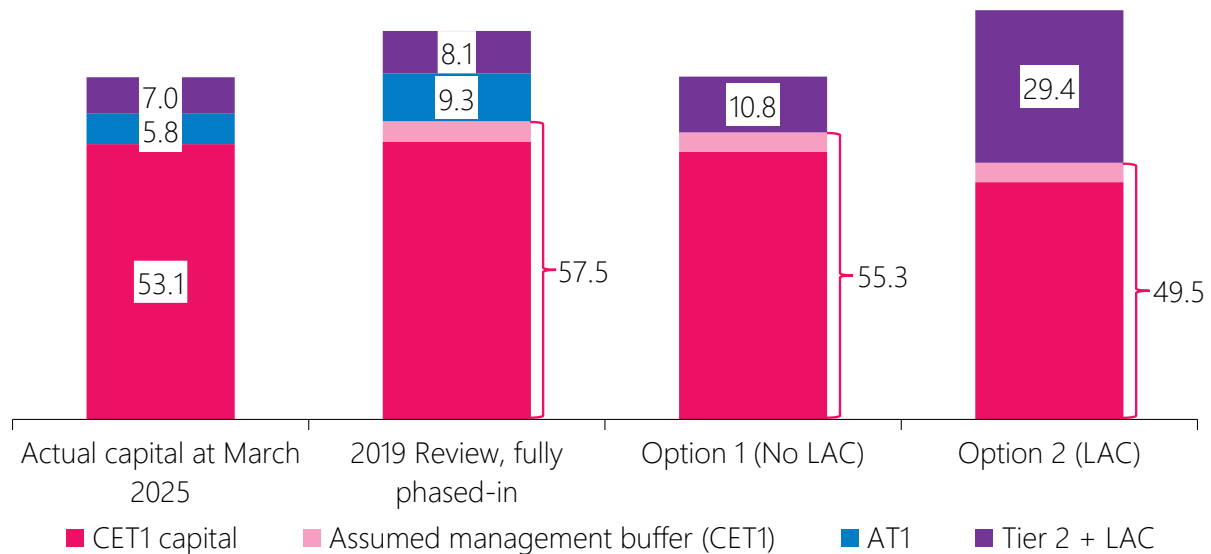
Table 2: Summary of current and proposed capital ratios (% of RWA)

		2019 Capital Review (once fully phased-in) and proposed DTA standard			2025 Capital Review consultation options			
		Group 1	Group 2	Group 3	Group 1, Option 1	Group 1, Option 2	Group 2	Group 3
Minimum Common Equity Tier 1 (CET1) capital		4.5	4.5	4.5	6	6	6	6
Minimum Tier 1 capital		7	7	7	6	6	6	6
Minimum Total capital		9	9	9	9	9	9	9
Internal Loss-Absorbing Capacity (LAC)		-	-	-	-	6	-	-
Prudential Capital Buffer (all CET1)		9	7	4*	8	6	5	4*
Totals	CET1	13.5	11.5	8.5	14	12	11	10
	Tier 1	16	14	11	14	12	11	10
	Total + LAC	18	16	13	17	21	14	13

*Note: We are proposing that an additional PCB of 1% would apply to Group 3 deposit takers without a credit rating.

Taken together, our proposals materially reduce capital requirements relative to prior decisions made in 2019. Combining the changes to both capital ratios and risk weights, Option 1 reduces total required capital by 12% relative to the fully phased-in 2019 Capital Review outcomes (see Figure 2 below). While Option 2 increases the amount of TLAC, the amount of CET1 required is around 10% lower than in Option 1. Both options are expected to result in lower average funding costs for deposit takers than under the 2019 Capital Review outcomes.

Figure 2: Summary impact on system level of bank capital (all locally incorporated deposit takers) (\$bn)



Source: RBNZ estimates.

The consultation does not set out a preferred option – and we are open to receiving feedback on alternative options. At this stage of the Review, we are seeking stakeholder feedback on these options and our preliminary analysis of their costs and benefits – and we are open to views that suggest adjusting these options.

While we recognise the influence our capital rules can have on economic output and competition, we want to be clear that even material changes to capital settings, such as those covered in this Consultation Paper, are not expected to translate into significant changes for the economy. While capital requirements can impact economic output and competition, there are other, more influential drivers. We anticipate the changes we are consulting on will have only minor impacts on economic activity and the attractiveness of the New Zealand market to new entrants. However, proposals to introduce more proportionality into capital requirements by reducing requirements for smaller deposit takers by more than larger deposit takers could have some impact on competition between existing players.

Next steps

Following this consultation, we will review all the feedback provided and aim to reach final decisions by the end of the year. We have engaged three independent experts – Thorsten Beck, Elena Carletti and Sir John Vickers – to challenge our analysis and to strengthen our final decision-making process. The experts will produce independent reports of their assessment of our revised capital settings for deposit takers. These reports will be published on our website once the Review has concluded.

1 Introduction

This chapter sets out:

- why we are doing this Review and what it covers (Section 1.1);
- what capital is, the different forms of capital and some background on our previous Review of capital settings (Section 1.2);
- how we are reviewing capital settings this time (Section 1.3); and
- how we are thinking about our risk appetite for this Review (Section 1.4).

1.1 What is the purpose and scope of this Review?

As set out in the Terms of Reference,⁸ the purpose of the Review of key capital settings is to assess whether the Reserve Bank's prudential capital requirements for deposit takers⁹ are set at the appropriate level to support a stable financial system – one where resilient financial markets, institutions and infrastructures enable a productive and sustainable economy and ultimately promote the prosperity and well-being of all New Zealanders.

Why are we reviewing capital settings now?

Between 2017 and 2019, we completed an extensive review of New Zealand's regulatory capital framework for registered banks (referred to as '**the 2019 Capital Review**').¹⁰ Since then, some submitters to the Commerce Commission's market study into personal banking services¹¹ and the Finance and Expenditure Committee's inquiry into banking competition¹² have expressed views that our bank capital settings are unreasonably conservative and that this is undermining competition and growth in the New Zealand economy.

We are in the process of updating all our prudential standards following the enactment of the Deposit Takers Act (**DTA**) in 2023. The DTA integrates the previously separate regulatory frameworks for registered banks and licensed non-bank deposit takers (**NBDTs**). The latter set of deposit takers was not part of the 2019 Capital Review.

Therefore, we consider now to be an appropriate time for a targeted review to reassess key capital settings across the entire deposit-taking sector.

8 Reserve Bank of New Zealand. (2025). *2025 Review of key capital settings: Terms of Reference*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/capital-review/2025/2025-review-of-key-capital-settings-terms-of-reference.pdf>

9 Deposit takers are financial institutions that borrow funds from depositors and other investors and lends to households and businesses. For the purposes of this document, 'deposit takers' refers to registered banks and licensed non-bank deposit takers that are currently regulated under separate legislative frameworks. The terms 'banking sector' and 'deposit-taking' sector are also largely being used interchangeably in this document. However, at present, only a subset of deposit takers is allowed to call themselves 'banks'.

10 Reserve Bank of New Zealand. (2025). *2017-2019 Capital Review*. <https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/how-we-regulate-and-supervise-banks/our-policy-work-for-bank-oversight/capital-review>

11 Commerce Commission. (2024). *Market study into personal banking services*. <https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-personal-banking-services>

12 To read the written submissions made on the inquiry, see New Zealand Parliament. (2025). *Submissions and Advice*. <https://www.parliament.nz/en/pb/sc/submissions-and-advice/>

What does this Review cover?

This is an evidence-based review. It builds on work that commenced in 2024 to review options for more granular risk weights for residential mortgages, corporate lending, rural lending and lending for housing for community housing providers, housing co-operatives, and whenua Māori.

To prioritise certainty for deposit takers, the scope of the Review is targeted to ensure that key concerns raised by stakeholders can be considered and addressed, while avoiding any unnecessary delays to the implementation of the DTA.

To achieve its purpose within the stated timeframe, the Review is limited to:

- An assessment of key developments since the 2019 Capital Review, including findings of the Commerce Commission's market study into personal banking services, the Finance and Expenditure Committee's inquiry into banking competition, and developments in regulatory and supervisory settings.
- An assessment of how our capital settings compare internationally and consideration of whether our capital settings are appropriate, given the risks that the New Zealand financial system faces.
- A reassessment of the appropriate risk appetite for capital settings in New Zealand – based on our statutory parameters including the purposes and principles of the DTA, the Proportionality Framework,¹³ and having regard to the Financial Policy Remit (**FPR**) (December 2024).¹⁴ We will also take into account the relevant Letter of Expectations from the Minister of Finance (although this is not a statutory instrument).¹⁵
- A review of the degree of proportionality in the capital framework, including consideration of any changes in capital ratios for different groups of deposit takers.
- Consideration of the balance between going concern and gone concern capital (including the proportion of Common Equity Tier 1 (**CET1**) relative to other forms of capital), the appropriateness of any additional Loss-Absorbing Capacity (**LAC**) requirements, whether we should continue to have Additional Tier 1 (**AT1**) capital as part of the New Zealand capital framework, and the interrelationship between capital and the crisis management framework.

The proposals in this consultation represent the views of the Reserve Bank. We have engaged three independent experts – Thorsten Beck, Elena Carletti and Sir John Vickers – to help challenge our analysis and to strengthen our final decision-making process. They will consider the options presented in this consultation, as well as the feedback from stakeholders on the proposals, alongside other information they think is relevant to the Review. The experts will produce independent reports of their assessment of our revised capital settings for deposit takers. Their assessments will be available to the Reserve Bank during the final decision-making stages of the Review. These reports will be published on our website once the Review has concluded.

¹³ Reserve Bank of New Zealand. (2024). *Proportionality Framework*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/dta-and-dcs/the-proportionality-framework-under-the-dta.pdf>

¹⁴ Reserve Bank of New Zealand. (2024). *Our Financial Policy Remit*. <https://www.rbnz.govt.nz/about-us/corporate-publications/our-financial-policy-remit>

¹⁵ Reserve Bank of New Zealand. (2025). *Our Letters of expectations*. <https://www.rbnz.govt.nz/about-us/corporate-publications/our-letters-of-expectations#sort=%40computedsortdate%20descending>

1.2 What is capital?

Deposit takers get their funding from two places – their owners (referred to as ‘shareholders’ or ‘members’) and people they borrow from (referred to as ‘creditors’, and includes both depositors and those that invest in the deposit taker’s debt instruments). The money that deposit takers get from their owners is generally referred to as ‘capital’ (or ‘equity’), while the money from their creditors is generally referred to as ‘debt’.

Financial returns to creditors are typically fixed (for example, via a set interest rate and repayment period), whereas returns to owners vary depending on the performance of the business (for example, the dividend can go up and down). Owners are typically the last to receive payment if a business gets into financial distress (this is known as the ‘creditor hierarchy’). Therefore, capital provides a financial cushion that can absorb losses before they impact depositors and other creditors.

When the amount of a deposit taker’s capital gets too low, and it cannot raise any more capital, the deposit taker is likely to fail. So, the more capital a deposit taker has, the more money it can stand to lose before it cannot pay its creditors. Higher levels of capital better protect depositors and promote financial stability, ensuring deposit takers are able to continue providing services to their customers even in ‘bad times’. Conversely, capital levels that are too high can reduce credit availability and increase costs unnecessarily.

What is the purpose of capital requirements?

Under Part 3 of the DTA, the Reserve Bank can issue a Capital Standard that covers the minimum capital requirements for deposit takers in New Zealand.¹⁶ The main purpose of the DTA is to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system. See Box A and Annex C for more details on the DTA.

By setting minimum capital requirements that reduce the risk of deposit taker failure, a Capital Standard will support the main purpose of the DTA. A Capital Standard will also support the following additional purposes of the DTA:

- to promote the safety and soundness of each deposit taker (section 3(2)(a));
- to promote public confidence in the financial system (section 3(2)(b)); and
- to avoid or mitigate the adverse effects of risks to the stability of the financial system (section 3(2)(d)(i)).

Deposit takers, like other businesses, use a mixture of capital and debt to fund their business activities. The choice between the two can be affected by a range of factors, including the cost of funding. In most parts of the economy, shareholders can be expected to make efficient decisions regarding how best to fund their activities without any need for regulatory intervention. However, it is an established finding in economic and financial literature that shareholders typically invest less capital in deposit takers than is socially optimal.¹⁷ This problem can arise because shareholders and

¹⁶ The DTA provides a single, coherent regulatory regime to enable robust regulation of all deposit takers.

¹⁷ The problem arises in large part because shareholders and creditors expect governments to bail out banks that are at risk of failing and whose failure would bring widespread social and economic costs. The expectation of bailouts means creditors are prepared to lend to banks when capital levels are low, generating socially sub-optimal levels of bank capital. For a comprehensive discussion of

creditors can expect governments to 'bail out' deposit takers that are at risk of failing, given that failure can bring widespread social and economic costs.

To address this problem, we – like other prudential regulators internationally – require deposit takers to have a minimum percentage of their funding that must come from their owners (or, in certain circumstances, creditors who hold subordinated debt instruments). These requirements help to ensure that there is sufficient funding available to absorb losses in most circumstances. Minimum capital requirements also ensure that owners have a meaningful stake in the business, incentivising them to manage risks prudently.

Capital requirements also protect the wider economy from the costs that can arise from the failure of financial institutions, and make sure that the deposit-taking system can continue to supply credit to the economy in times of economic stress, reducing the negative feedback loops that can occur between financial losses to banks and the real economy.

What are the different forms of capital and other loss-absorbing instruments?

Currently, there are three 'tiers' of recognised capital in New Zealand:

- **CET1 capital** is the highest quality of capital as it is permanently available to absorb a deposit taker's financial losses. CET1 includes shareholders' investment (ordinary shares) and the deposit taker's retained earnings.
- **AT1 capital**, which includes perpetual preference shares, is the second highest quality of capital behind CET1.
- **Tier 2 capital**, which includes some subordinated debt, is capital that can generally only absorb losses once a bank has failed. It is therefore considered of lower quality than Tier 1.

As indicated in the Terms of Reference, this Review also considers the interrelationship between capital and the crisis management framework, in respect of both the amount and form of capital. This includes consideration of the balance between 'going concern' and 'gone concern' capital and the appropriateness of any LAC requirements. For the purposes of this Consultation Paper, we define these terms as follows:

- **Going concern capital** comprises instruments that absorb losses while the deposit taker remains an economically viable entity. These instruments help maintain ongoing operations and market confidence.
- **Gone concern capital** comprises instruments that absorb losses once the deposit taker is no longer economically viable. This includes a regulator-led bail-in using crisis management powers, as without that intervention the deposit taker could not have continued operating or sustained market confidence.

Going concern capital is designed to absorb losses to reduce the *probability* of distress, while gone concern capital can enable an enhanced range of crisis management options when a deposit taker is likely to fail (or has failed), reducing the *impact* of distress on the financial system.

the 'moral hazard' problem associated with expected bank bailouts, see Barth, J. R., Capiro, G., & Levine, R. (2012). *Guardians of Finance: Making Regulators Work for Us*. The MIT Press.

What are the different groups of deposit takers?

Our Proportionality Framework¹⁸ categorises locally incorporated deposit takers into three groups, depending on their size:

- **Group 1 deposit takers** (total assets of NZ\$100 billion or more);
- **Group 2 deposit takers** (total assets of NZ\$2 billion or more, but less than NZ\$100 billion); and
- **Group 3 deposit takers** (with total assets of less than NZ\$2 billion).

Overseas deposit takers that operate in New Zealand as branches are not therefore subject to the Proportionality Framework, nor to the Reserve Bank's capital requirements.

Key decisions from the 2019 Capital Review

Over 2017 to 2019, we completed an extensive process to reform our capital framework for banks. The 2019 Capital Review resulted in the decision to significantly increase the quantity and improve the quality of capital that Group 1 and Group 2 deposit takers were required to have in order to improve the resilience of the banking system. The changes resulting from the 2019 Capital Review are currently being implemented and are not scheduled to be fully phased in until July 2028.

The key decisions from the 2019 Capital Review on the amount of capital were:

- a minimum total capital ratio requirement of 9% of risk weighted assets (**RWA**) for Group 1 and Group 2 deposit takers;
- in addition to the 9% of RWA minimum, Group 1 deposit takers would be expected to have a prudential capital buffer (**PCB**) of 9% of RWA; and
- in addition to the 9% of RWA minimum, Group 2 deposit takers would be expected to have a PCB of 7% for RWA.

Increases in PCBs are still in the process of being phased-in, with around half of the scheduled increases in place to date. All banks currently face a minimum total capital requirement of 9% of RWA, compared with 8% in 2019. Buffer requirements increased to 5.5% in July 2025 for domestic systemically important banks (**D-SIBs**), up from 2.5% in 2019, with further increases scheduled to take the buffer to 9% in 2028. For non-D-SIBs the buffer has increased from 2.5% to 3.5%, with further increases scheduled to take the buffer to 7% in 2028.

DTA Core Standards Consultation 2024

Section 2.1 explains the legislative changes since the 2019 Capital Review, including the enactment of the DTA in 2023.

Following the enactment of the DTA, we consulted on policy positions for a new Capital Standard in 2024.¹⁹ In that consultation, we proposed to largely replicate the requirements being

¹⁸ Reserve Bank of New Zealand. (2024). *Proportionality Framework*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/dta-and-dcs/the-proportionality-framework-under-the-dta.pdf>

¹⁹ Reserve Bank of New Zealand. (2024). *Deposit Takers Core Standards: Policy proposals*. https://consultations.rbnz.govt.nz/dta-and-dcs/deposit-takers-core-standards/user_uploads/deposit-takers-core-standards-consultation-paper-1.pdf

implemented following the 2019 Capital Review for Group 1 and 2 deposit takers. We also proposed new capital requirements for Group 3 deposit takers.

For areas outside the scope of this Review (for example, our approach to market and operational risk), we have considered feedback on the 2024 Core Standards consultation and made final policy decisions. These decisions are set out in the Summary of Submissions and Policy Decisions for the Capital Standard (referred to as '**the Response Document**') which has been published alongside this consultation.²⁰

However, the Response Document does not include policy decisions on the key capital settings covered by this Review. Instead, this Consultation Paper sets out new proposals for feedback.

Box A: Issuing standards under the Deposit Takers Act 2023

The Reserve Bank may issue standards under the DTA where we are satisfied that the standards are necessary or desirable for one or more purposes of the Act. The main purpose of the DTA is to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system. The Act also has a number of additional purposes including promoting the safety and soundness of each deposit taker, and promoting public confidence in the financial system.

When deciding whether to issue standards we are also required to have regard to:

- certain principles in the Act, including the desirability of deposit takers effectively managing their capital, liquidity and risk, the need to maintain competition within the deposit-taking sector, and the need to avoid unnecessary compliance costs; and
- the most recent Financial Policy Remit issued by the Minister of Finance, which sets out matters the Minister thinks it is desirable for the Reserve Bank to have regard to in certain circumstances (including when issuing standards).

Decisions on whether to issue standards are also informed by a variety of non-legislative documents including the Reserve Bank Boards' Risk Appetite Statement, and the relevant Letter of Expectations from the Minister of Finance.

The purposes of the DTA and principles we are required to have regard to under the DTA are set out in Annex C.

From late 2028, the Capital Standard will cover the minimum capital requirements for deposit takers in New Zealand. The proposals in this Consultation Paper, alongside the decisions set out in the Response Document, are designed to support the main purpose of the DTA – to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system. The proposals also

²⁰ Reserve Bank of New Zealand. (2025). *Deposit Takers Core Standards: Summary of Submissions and Policy Decisions for the Capital Standard*. https://consultations.rbnz.govt.nz/dta-and-dcs/deposit-takers-core-standards/user_uploads/summary-of-submissions-policy-decisions-capital-standard.pdf

establish minimum standards of safety and soundness for each licensed deposit taker, while mitigating adverse effects of risks to the stability of the financial system.

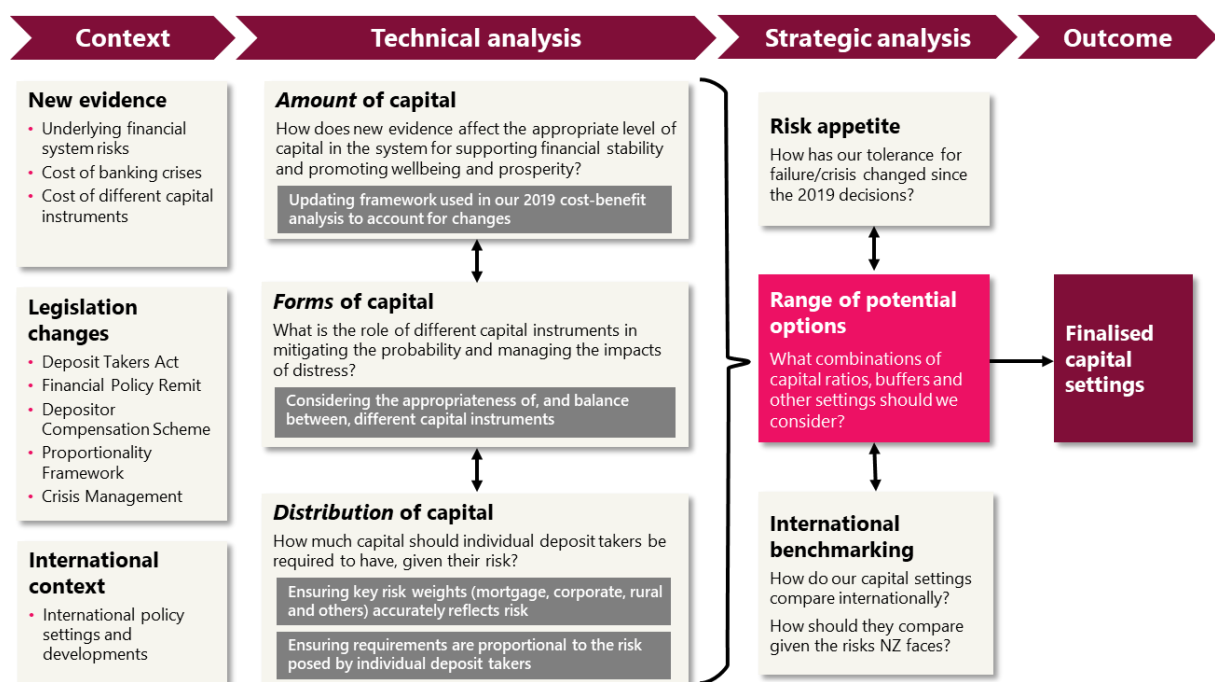
1.3 How are we reviewing our capital settings?

We are carrying out an evidence-based review that will be informed by the advice of independent international experts, and by feedback on this Consultation Paper. This subsection provides further detail on the high-level analytical approach and assessment criteria we propose using in the Review.

High-level analytical approach

Figure 3 below illustrates our analytical approach to the Review. It comprises three broad analytical stages to arrive at our finalised capital settings.

Figure 3: Analytical approach to the Review of key capital settings



First, we are considering changes to context since the 2019 Capital Review, including new evidence, changes in legislation (including new statutory purposes under the DTA and a new FPR) and policy, and developments internationally. This is summarised in Chapter 2.

Second, we are considering the appropriate amount, form and distribution of capital for New Zealand. This covers a range of interrelated topics that we cover throughout the remainder of this Consultation Paper, including:

- **The role of LAC:** This informs the appropriate *form* of capital for Group 1 deposit takers. It is closely related to our future approach to crisis management, which is covered in Section 2.1.
- **Applying proportionality:** This informs how the *distribution* of capital in the system reflects that different deposit takers present different risks to financial stability. We summarise our proposed options across different groups of deposit takers in Chapter 3.

- **The role of AT1 capital:** This informs the appropriate *form* of capital and is covered in Chapter 4.
- **Reviewing key risk weights:** This informs how the *distribution* of capital in the system reflects differences in credit risk exposures across deposit takers. It is covered in Chapter 5.
- **Updated cost benefit analysis:** This is largely to inform the *amount* of capital that would be appropriate for New Zealand, and is covered in Section 3.6 and Annex E.

To inform the proposals in our Consultation Paper, we have also undertaken strategic analysis. This includes considering the appropriate risk appetite for New Zealand and benchmarking our requirements against international comparators. While our technical analysis is fundamental to identifying an appropriate set of options, it is not in itself sufficient to determine what settings are best for New Zealand.

Assessment criteria for this Review

Our legislation empowers us to set capital requirements and provides the basis on which we calibrate these and other prudential settings. It does this by setting out the purposes and principles of the DTA (see Box A and Annex C), which support the overarching purpose of promoting the prosperity and well-being of New Zealanders. The Reserve Bank Act 2021 also requires us to have regard to the FPR issued by the Minister of Finance.

To articulate what the key factors are for this Review, we have developed the following assessment criteria. These criteria are a helpful tool in assessing potential capital settings, but do not replace the statutory parameters on which we must ultimately base our decisions.

Financial stability criteria

1. **Going concern loss absorbency:** Maintain a sufficient prudential capital buffer above the regulatory minimum to absorb losses, protect and promote the stability of the financial system, and promote the safety and soundness of each deposit taker (links to DTA section 3(1) and 3(2)(a) purposes).
2. **Crisis management:** Enable a distressed deposit taker to be dealt with in an orderly manner, recognising the need for a credible resolution strategy for deposit takers to promote financial stability and avoid the use of public money (links to DTA section 259 purposes).

Other criteria

3. **Proportionality:** Take a proportionate approach to regulation and supervision (links to DTA section 4(a)(i) and (ii) principles).
4. **Competition:** Maintain competition within the deposit-taking sector, recognising the desirability of a diverse deposit-taking sector that provides financial products and services to a diverse range of New Zealanders (links to DTA section 3(2)(c) purpose, and section 4(a) and (b) principles).
5. **Funding costs:** Consider the impact on deposit takers' weighted average funding costs, which in turn affect lending rates, recognising their importance for supporting the prosperity and well-being of New Zealanders (links to DTA section 3(1) and 3(2)(d) purposes).

- 6. Simplicity/achievability:** Be practical to administer, easy to implement and avoid unnecessary compliance costs (links to DTA section 4(c) principle).
- 7. International alignment:** Align with international standards where appropriate (links to DTA section 4(d) principle).

The 'right' capital settings for New Zealand will depend on how we balance these different assessment criteria. A key judgement is the balance between 'financial stability' and 'other' objectives. Another key judgment is how we balance different financial stability criteria – we need to consider the balance between going concern loss absorbency and crisis management in achieving financial stability.²¹

As well as considering options against these assessment criteria, Section 3.6 and Annex E of this paper provide our preliminary assessment of the quantifiable costs and benefits. The quantified costs and benefits cover criteria 1, 2 and 5 from the list above. We are seeking feedback regarding our assessment of costs and benefits, and we will consider any feedback before finalising our cost benefit analysis.

Q1 Do you have any comments on the proposed assessment criteria?

1.4 What is the appropriate risk appetite for capital settings in New Zealand?

What is a risk appetite for capital settings?

When setting regulatory capital requirements, the Reserve Bank is effectively calibrating the frequency and severity of banking system stress events in New Zealand. This task involves balancing the benefits of higher capital levels, in terms of improved financial system stability, against potential costs, such as economic output that may be foregone from imposing excessively high requirements. This calibration ultimately reflects our "risk appetite" for capital settings.

Parliament has delegated authority to the Reserve Bank to set prudential requirements, including capital, and we must do so within the legislative context under the Reserve Bank of New Zealand Act 2021 and the DTA. This includes a role for the Minister of Finance to provide a FPR for us to have regard to. This model is consistent with the Basel Committee's Core Principles for Effective Banking Supervision²² – the international benchmark for prudential regulation and supervision.

The significance of risk appetite arises, in part, because there are a range of potential capital settings that could meet our statutory purposes. Where we land therefore depends on how we balance different factors within the legislative framework that we must work within (for example, how we balance financial stability and efficiency or competition). Further, the net benefit of capital for society is subject to significant uncertainty. For example, the timing, impact and scale of future shocks is unknown, as is the impact that capital would have on these variables.

²¹ As discussed further in Section 2.1, putting more weight on the crisis management framework contained in the DTA may result in an increase in the amount of gone concern relative to going concern capital in the capital stack, or lower minimum capital requirements. However, it may also potentially mean more fulsome crisis preparedness requirements for both the Reserve Bank and industry in the future.

²² Basel Committee on Banking Supervision. (2012). *Core Principles for Effective Banking Supervision*. <https://www.bis.org/publ/bcbs230.pdf>

What was our risk appetite during the last review?

During the 2019 Capital Review, we agreed on a risk appetite that would focus on a simple, but conservative, use of capital requirements to support stability.²³ We expressed our risk appetite using a risk tolerance for systemic crisis of “1-in-200 years”. This meant that we considered the decisions would ensure that there was sufficient capital in the system to avoid that capital being fully depleted in a severe economic shock equivalent to what might be expected once every 200 years. Once a shock exceeded that level, then the associated losses would completely wipe out all capital in the system. Smaller events (for example, a 1-in-50 year, or 1-in-100 year shock) might be sufficient to lead to some bank failures, but would not be large enough to wipe out capital across the whole system.

In 2019, our Regulatory Impact Assessment estimated that the 1-in-200 year risk tolerance provided a net benefit for New Zealand. This reflects the severe impacts financial crises can have across many aspects of economic and social activity. It was also aligned with prudential settings in the insurance sector and focus group workshops to get views from New Zealanders about their level of comfort with risks to financial stability.

How have we approached risk appetite in this Review?

As discussed in Section 1.3, a key component of this Review is to reassess our risk appetite.

We have decided to no longer set policy requirements and communicate our risk appetite for financial stability using a “1-in-X many years” risk tolerance. While this has previously been a useful way to communicate that the setting support resilience of the financial system and the economy, we are looking towards greater international alignment in our approach. The metric is unusual internationally – New Zealand is the only jurisdiction, that we are aware of, where such a measure is used. In addition, the wider range of approaches to crisis management considered in this Consultation Paper are not well-suited to a single 1-in-X year metric.

What should our risk appetite be now?

Our risk appetite should be based on our statutory parameters including the purposes and principles of the DTA. For example, the main purpose of the DTA is “to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system”. We also consider the Proportionality Framework, and have regard to the December 2024 FPR. The FPR stresses the importance of improving competition in the financial sector and accepts that failures of individual institutions will occur from time to time. The FPR is consistent with tolerating slightly more risk of firm failure if doing so can deliver material benefits in terms of economic activity and financial sector competition.

There are a range of capital settings that can meet our legislative mandate for financial stability. Under the Reserve Bank of New Zealand Act 2021, the Reserve Bank now has a Board which is responsible for determining the risk appetite for various regulatory outcomes – including capital

²³ Reserve Bank of New Zealand. (2019). *Capital Review Paper 4: How much capital is enough?*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/capital-review-consultation-how-much-capital-is-enough.pdf>

settings. Under this risk appetite we have a low appetite for any action or inaction that materially reduces financial system stability, but do not run a zero-failure regime.²⁴

This Consultation Paper seeks feedback on options calibrated to a higher risk appetite than in the 2019 Capital Review. A key reason for the change in risk appetite is that under the DTA (once fully implemented) we will have more comprehensive tools for supervision and crisis management (see Section 2.1).

We have also looked at where New Zealand's capital requirements sit compared to other jurisdictions after making adjustments for comparability (Section 2.3). This suggests that our current Tier 1 settings are likely one of the highest of our comparator countries – and continuing to increase capital requirements in line with the 2019 Capital Review would move us higher still.

We recognise that stakeholders will have different views about the appropriate risk appetite for New Zealand. This public consultation is designed, in part, to test stakeholders' views and we are seeking feedback on whether the options proposed in Chapter 3 get the balance right.

Q2 Do you have any comments on the appropriate risk appetite for New Zealand's capital settings?

²⁴ Reserve Bank of New Zealand. (2022). *Statement of Prudential Policy*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/statements-of-approaches/sopp-2022.pdf>

2 Context

As set out in our approach to this Review (Section 1.3), we have assessed the key context for capital settings in New Zealand and how this has changed since the 2019 Capital Review. This chapter:

- considers legislative and policy changes since 2019 (Section 2.1);
- assesses new evidence on underlying financial system risks in New Zealand (Section 2.2); and
- summarises how New Zealand's capital requirements compare internationally (Section 2.3).

This assessment provides important context for this Review and supports our analysis of the appropriate options (Chapters 3, 4 and 5), informed by our risk appetite (Section 1.4).

2.1 Legislative changes since 2019

Introduction of the Deposit Takers Act 2023

The key legislative change since the 2019 Capital Review is the introduction of the Deposit Takers Act 2023 (**DTA**). Currently, we regulate and supervise banks under the Banking (Prudential Supervision) Act 1989. We also regulate and license Non-bank Deposit Takers (**NBDTs**) under the Non-bank Deposit Takers Act 2013 and work with the trustee companies that supervise them. From 2028, both Acts will be superseded by the DTA and all deposit takers will come under a single regulatory framework.

The key aspects of the new DTA framework that are relevant to this Review include:

- The introduction of new purposes under section 3 of the DTA, particularly the additional purposes to promote the safety and soundness of each deposit taker.
- The publication of the Proportionality Framework under section 77 of the DTA, which sets out how we take a proportionate approach when developing prudential standards for licensed deposit takers under the DTA.²⁵
- The development of prudential standards under the DTA, including a Capital Standard, which will set prudential requirements for all deposit takers. The impact of the DTA standards on capital is discussed in Table 3 below. Standards will replace our current rulebook for banks and the NBDT regulations.
- The introduction of the Depositor Compensation Scheme (**DCS**), which covers up to \$100,000 per depositor in each deposit taker (this is also discussed in Table 3 below).²⁶
- A new crisis management framework under Part 7 of the DTA, which introduces new objectives, functions, powers and duties related to dealing with distressed deposit takers. More details on our crisis management framework, and the upcoming work to operationalise it, are set out below.

²⁵ Reserve Bank of New Zealand. (2024). *Proportionality Framework*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/dta-and-dcs/the-proportionality-framework-under-the-dta.pdf>

²⁶ Deposit Takers Act 2023, pt 6. <https://www.legislation.govt.nz/act/public/2023/0035/latest/LMS469449.html>

- The Reserve Bank is required to have regard to the Financial Policy Remit (**FPR**) when making significant prudential policy decisions or issuing and reviewing standards. Since December 2024, the FPR includes the desire to “achieve financial stability, while encouraging competition and the efficient provision of financial services”. The FPR also stresses the importance of improving competition in the financial sector and accepts that failures of individual institutions will occur from time to time.

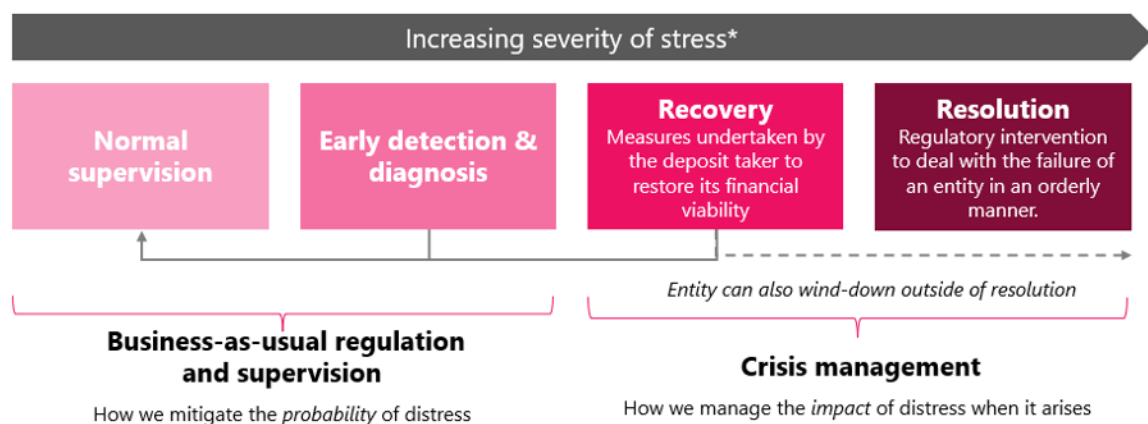
The impact of the new DTA framework, as well as other policy changes, on the appropriate capital settings for New Zealand is considered below in Table 3.

Crisis management under the DTA

Crisis management refers to the actions taken by deposit takers, the Reserve Bank and other stakeholders to avoid significant damage to the financial system that could result from a deposit taker being in financial distress or other difficulties.²⁷ Crisis management actions cover those taken during the ‘recovery’ process, and those taken in ‘resolution’ when a deposit taker has failed or is likely to fail.

As illustrated by Figure 4 below, crisis management is part of our broader regulatory and supervisory framework for deposit takers. Our regulatory and supervisory activities seek a low *probability* of distress to promote financial stability.²⁸ If a deposit taker faces financial distress or other difficulties, we respond to reduce the *impact* of distress to meet the DTA purposes.

Figure 4: A continuum of our responses to address financial distress or other difficulties



The DTA modernises New Zealand’s crisis management framework in a number of ways. In particular, it:

- Sets out the purposes that the Reserve Bank must act for when dealing with a deposit taker in distress (see Annex C).

²⁷ In the case of the Reserve Bank, this includes actions taken to support the purposes in section 259, Part 7 of the DTA. These purposes are set out in Annex C.

²⁸ Reserve Bank of New Zealand. (2022). *Statement of Prudential Policy*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/statements-of-approaches/sopp-2022.pdf>

- Provides a broad and responsive crisis management toolkit, including prudential standards, early intervention powers, and investments in ensuring deposit takers can continue to provide systemically important activities in crisis conditions (and be resolved in an orderly manner).
- Requires the Reserve Bank to:
 - publish a Statement of Approach to Resolution (**SoAR**)²⁹ which sets out our expected resolution strategy or strategies for dealing with licensed deposit takers; and
 - maintain a resolution plan for each licensed deposit taker.

In addition, the DTA establishes the DCS which protects up to \$100,000 in eligible deposits on a “per customer, per deposit taker” basis.

Collectively, this represents a significant investment in a stronger crisis management framework for New Zealand, amplified in the wake of the Global Financial Crisis (**GFC**).

In August 2024, we published an Issues Paper on Crisis Management under the DTA (**‘Issues Paper’**)³⁰ which sought feedback on several issues that are key to operationalising this new crisis management framework. As highlighted in the Issues Paper, the implementation of this framework requires further substantive policy and operational work over several years.

The interrelationship between capital and crisis management

As indicated in the Terms of Reference, this Review considers the interrelationship between capital and the crisis management framework, in respect of both the amount and form of capital.

Our thinking on the interrelationship between capital and crisis management is informed by the crisis management framework in the DTA, including the work required to implement and operationalise this framework. In this respect, we note that reducing capital requirements would increase the probability that a deposit taker may enter into the crisis management phases of the continuum in Figure 4 above. Accordingly, this additional risk of deposit taker failure would need to be factored into the SoAR, individual deposit taker resolution plans, and potentially more fulsome requirements for crisis preparedness and pre-positioning for resolution for both industry and the Reserve Bank.

Bail-in and loss-absorbing capacity

Bail-in is a crisis management strategy that seeks to recapitalise a deposit taker that is otherwise likely to fail (or has failed) by writing down, or converting into ordinary shares, selected capital instruments and liabilities. As discussed in the Issues Paper, a bail-in strategy in general could be implemented in a variety of different ways (for example, through contractual terms, the use of transfer powers, or through more explicit statutory bail-in powers). We are still considering the role of bail-in in our crisis management framework.

In addition, there are a range of potential funding sources for a bail-in strategy. Existing capital resources (**‘the capital stack’**) should provide an initial source of funds, but they are likely to be

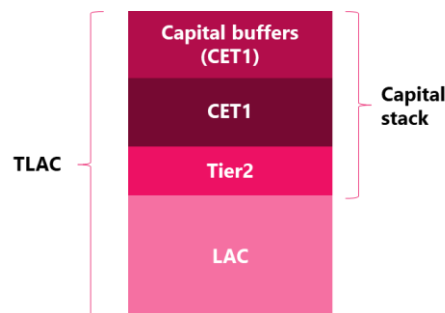
²⁹ The first SoAR is required to be published within one year of Part 7 coming into force. We currently expect that Part 7 will come into force in mid-2028. If so, the first SoAR will need to be published by mid-2029.

³⁰ Reserve Bank of New Zealand. (2024). *Crisis Management under the Deposit Takers Act 2023*. https://consultations.rbnz.govt.nz/dta-and-dcs/crisis-management-under-the-deposit-takers-act/user_uploads/crisis-management-issues-paper-august-2024.pdf

significantly depleted if a deposit taker is likely to fail (or has failed). To implement a bail-in strategy, the resolution authority may therefore need to consider other available funding sources, such as Loss-Absorbing Capacity (**LAC**) from investors in the distressed deposit taker.

Accordingly, as part of this Review, we are considering the role of a LAC requirement set in addition to capital requirements (as illustrated in Figure 5 below).³¹ Any LAC requirement would consist of pre-positioned debt instruments, the outstanding balance of which could be written-down or converted into equity when a deposit taker is in distress. Write-off or conversion acts to increase a deposit taker's equity (either by reducing the fixed liabilities on the deposit taker's balance sheet or by converting a portion of those liabilities from debt into equity).

Figure 5: Illustration of the capital stack and LAC



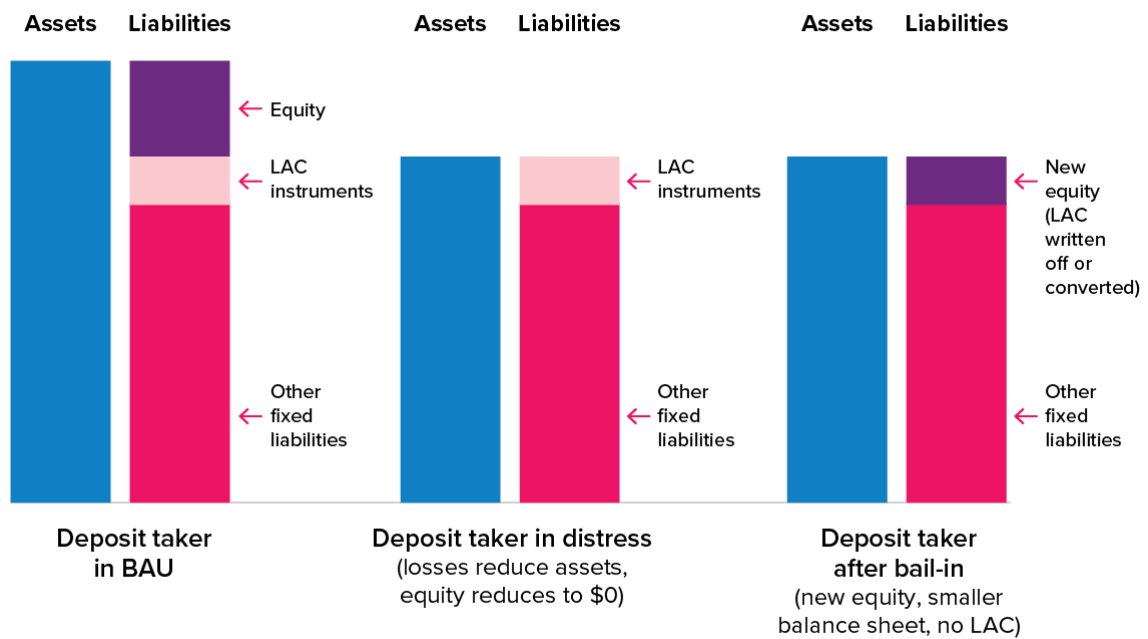
LAC can be issued externally to the market or internally within a group to the parent entity (see Box B below). Internal LAC is a mechanism by which losses and the recapitalisation needs of a material subsidiary may be passed to the parent.^{32,33} This is achieved by contractually writing down or converting the internal LAC without the subsidiary entering into a resolution procedure, as illustrated in the diagram below.

³¹ While these instruments are formally outside the capital stack, in some cases the same instruments can meet the requirements to qualify as Tier 2 capital instruments or additional LAC instruments.

³² The Financial Stability Board has published the Guiding Principles on Internal Total Loss-Absorbing Capacity of G-SIBs ('Internal TLAC'). To read the BIS's summary of the guiding principles, see Bank for International Settlements. (2020). *Internal TLAC – Executive Summary*. https://www.bis.org/fsi/fsisummaries/internal_tlac.htm

³³ On the other hand, when external LAC is written-down or converted, investors holding the instruments bear the losses or have these instruments converted into equity.

Figure 6: Illustrative use of LAC instruments



International capital frameworks increasingly include LAC to support bail-in crisis management strategies, (as discussed in Section 2.3). However, LAC is not currently included in New Zealand's capital framework.

Box B: Loss-absorbing capacity and international groups

It is not possible to predict with certainty when, or how, a crisis will occur. As discussed further in Section 2.2, international experience highlights the need for crisis management strategies to be flexible and provide for optionality. Strategies of this sort will help ensure that the Reserve Bank can effectively deal with a broad range of circumstances that could result in a deposit taker failure and meet the purposes of the DTA.

In New Zealand, our four largest deposit takers are subsidiaries of Australian parents (the Group 1 deposit takers).

Our preferred crisis management approach for Group 1 deposit takers is an Australian-led 'group' resolution approach, under which the Australian parent would transfer or 'downstream' sufficient capital to the New Zealand subsidiary to restore its viability. In the international literature, this is often described as a 'single point of entry' (**SPE**) approach to multinational banks.

When we present our capital stack options in Chapter 3 of this Consultation Paper, we particularly emphasise the role that internal LAC could play in an SPE strategy. Internal LAC instruments issued by the New Zealand subsidiary to its Australian parent would be one mechanism for facilitating capital transfer in a crisis, though it is not the only possible mechanism.

However, the existence of internal LAC instruments does not guarantee a successful recovery or resolution. The process is still a complex one. For example, if the Australian parent did not have enough capital of its own, it might need to work with Australian regulators to pursue resolution or recovery actions once the LAC was triggered. If those actions were unsuccessful, or the New Zealand entity required more capital than is pre-positioned by the LAC, the crisis management strategy may not be successful.

It is therefore important for us to maintain flexibility by having fallback options, including options that would result in the separation of the New Zealand subsidiary from its parent. We are considering these options as part of our broader work on implementing the DTA crisis management framework (see the Issues paper). These approaches are likely to draw on the Reserve Bank's existing Outsourcing and Open Bank Resolution requirements. We are also due to report back to the Minister of Finance on whether statutory bail-in could play a role in a fallback solution shortly after this Review is complete.

Impact of policy changes on appropriate capital requirements

Table 3 below summarises our assessment of how policy changes since the 2019 Capital Review affect the appropriate amount of capital in the financial system.

Regardless of their impact on capital, these policy changes deliver many benefits for New Zealand's financial system including harmonised regulations across deposit-taking institutions, strengthened crisis management and enhanced macroprudential oversight. However, many of

these benefits are partly complementary to capital, rather than directly substitutable. For example, they may help tackle non-financial risk in the financial system.

Cumulatively, policy changes such as the upcoming DTA changes – once fully implemented – should lower risk in the system and could suggest it would be appropriate to have lower capital requirements.

Table 3: Implication for capital from policy changes since 2019

Policy changes	Assessment
DCS	Minimal impact on capital settings The DCS came into effect on 1 July 2025, protecting up to \$100,000 per depositor per institution. The DCS will impact risk and therefore capital requirements in two opposing ways: • by improving financial stability through timely access to funds and reduced likelihood of bank runs, which would allow for lower capital requirements; and • by increasing moral hazard risk, which would require higher capital requirements. As the DCS is so new, we cannot be certain which of the above factors will have more impact. • At a system level – international evidence suggests that moral hazard will have a larger impact which would suggest higher capital requirements. However, we do not expect the moral hazard risk to be as large for New Zealand due to the conservative nature of the deposit-taking sector relative to most countries. Also, risk-based capital requirements are already increasing the capital requirements for higher risk. • DCS levies are only partly risk based. Combined with depositors looking for high-yield insured deposits, the moral hazard risk for Group 3 deposit takers increases under the DCS. However, in response to the lower likelihood of bank runs, we have decided to reduce the liquidity requirements for insured deposits under the forthcoming DTA Liquidity Standard. Decreasing capital in addition to this could be overstating the decrease in risk from the DCS.
Activation of Debt-to-Income (DTI) restrictions	May support lower capital requirements Macroprudential tools are used to reduce the systemic risk associated with extremes in credit cycles in which the financial system can amplify severe downturns in the real economy. They are complements – rather than substitutes – for capital requirements which focus on underlying, structural risks. DTIs, if they become binding during strong credit growth, may remove some of the riskiest residential mortgage lending that has the highest probability of default. This decreases the risk deposit takers can take on during a housing market upswing. The lower flow of high-risk residential lending will overtime decrease the risk of the overall residential lending stock. However, for Group 1 deposit takers, any reduction in DTIs will flow through into lower risk in their IRB modelling and will decrease the amount of capital they must have, partly offsetting the risk reduction from DTIs. Given that Group 1 deposit takers have around an 87% market share (see Figure 8 in Section 2.2), this means lower capital partially offsets the benefits of DTIs at a system level. DTIs also help lower the macroeconomic risk from housing bubbles by decreasing the amount of high-DTI borrowing that deposit takers can do. Thus, lowering the amplitude of the cycle peak.

Policy changes	Assessment
More intensive supervision	May support lower capital requirements Prior to 2019, the Reserve Bank had a relatively lighter touch approach to supervision than most international prudential regulators. Since 2019, the Reserve Bank has begun to pivot toward a more intensive supervisory framework, which will include elements such as increased on-site inspections and engagement once the DTA is fully implemented in 2028. More intensive supervision does not automatically suggest that capital requirements should be less stringent. Capital requirements and our approach to supervision are partly complementary rather than directly substitutable. This is because supervision promotes deposit takers' compliance with regulations – such as capital requirements – and assesses if they are operating prudently. Overall, more intensive supervision lowers the probability of individual deposit taker failure and therefore lowers the risk to the overall financial system. The uplift in supervisory intensity is larger for Group 2 and 3 deposit takers. Group 1 deposit takers already have more developed internal risk management arrangements, as well as greater supervision requirements from the Reserve Bank and from the Australian Prudential Regulatory Authority (APRA) via their parent group. Therefore, we do not expect a large risk reduction at the system level given the relative market share of Group 1 deposit takers.
DTA – introducing new prudential standards	May support lower capital requirements Prudential regulatory capital requirements help to ensure that deposit takers remain solvent. For example, capital provides buffers to prevent failure, and this is accompanied by other prudential standards for entities to manage the risks of failure financially and operationally. Standards made under the DTA will impose stricter non-capital rules, albeit tailored across the three deposit taker Groups under the Proportionality Framework. The changes include addressing weaknesses or outdated parts of the current regulations. These changes help lift our risk management in non-capital areas. For example, new requirements to lift entities' risk management capability will improve their resilience to both financial and operational risks. As a result, deposit takers are typically less likely to suffer losses. Therefore, they may not need to have as much capital to cover unexpected losses as both the likelihood and the scale of losses should be reduced. However, these changes are not exact substitutes for capital requirements. Each set of rules addresses different dimensions of risk. Cumulatively, these changes should lower the risk in individual deposit takers. By lowering the risk in individual deposit takers, it also helps lower the risk to the overall system.
Enhanced stress testing	Minimal impact on capital Since 2019, we have increased the stress testing regime intensity, including forming a dedicated Stress Test team in the Reserve Bank and introducing an annual industry stress test programme. Stress tests assess deposit takers against defined stress scenarios and help us identify both system risks and risks in individual deposit takers. The enhanced stress testing regime allows us to test more types of risks and to test more frequently, enhancing deposit takers' prudential operations by increasing their awareness of risks. They provide an assessment of the adequacy of capital buffers in different scenarios and test plans for how deposit takers would restore capital buffers in these scenarios. However, stress test results are limited to the specific scenario being tested. Stress tests are also sensitive to underlying assumptions and it is difficult to capture the real-world complexities of a financial crisis. Therefore, a given stress scenario will not capture all

Policy changes	Assessment
	possible risks facing the financial system. Capital provides the base level of financial stability and stress tests can help identify and assess specific risks.
Strengthening of the Credit Contracts and Consumer Finance Act (CCCFA)	Minimal impact on capital An updated and strengthened version of the CCCFA was released in 2021 with stricter rules for lenders before issuing credit. However, many of the stricter rules have since been wound back. The current rules are stricter than in 2019 but are mainly focused on smaller product lines. For the largest product lines (for example, residential mortgage lending) the CCCFA rules are similar to the 2019 settings.

Q3 Do you have any feedback on our assessment of the impacts of legislative and policy changes since 2019?

2.2 New evidence

In this section we briefly discuss evidence observed after the 2019 Capital Review. It includes the factors that may potentially affect funding costs, lending rates and competition, and a reassessment of some of the key risk factors that underpinned the 2019 Capital Review decisions.

Feedback received to the Commerce Commission market study and Select Committee inquiry into banking competition

We have reviewed submissions made to the recent Commerce Commission's market study into personal banking services and Finance and Expenditure Committee (FEC) inquiry into banking competition.

The Commerce Commission market study investigated factors that may affect competition for the supply or acquisition of personal banking services in New Zealand. The final report, published in August 2024, included several recommendations for the Reserve Bank to ensure the regulatory environment better supports competition.³⁴ These included implementing more granular standardised risk weights for residential mortgage lending and considering standardised risk weights for lending for collective and social housing, and for lending for housing on Māori freehold land.

As discussed further in Chapter 5, we are proposing changes to risk weights in many of the areas highlighted by the Commerce Commission market study. However, we continue to see capital requirements as just a small part of the puzzle when it comes to competition in the deposit-taking sector, as discussed in Box C.

Some submissions to the FEC inquiry argued that New Zealand's capital requirements are overly conservative. For example, submitters were asked to provide estimates of the potential impact of the 2019 Capital Review decisions on lending rates. Group 1 deposit takers submitted that lending rates could be between 40 – 75 basis points higher by 2028 than they would have been if capital

³⁴ Commerce Commission. (2024). *Market study into personal banking services*. <https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-personal-banking-services>

requirements remained at pre-2019 levels.³⁵ This is higher than the estimates from our 2019 Regulatory Impact Assessment of a 20 – 40 basis points increase in lending rates.³⁶ Higher-than-expected pass-through of capital requirements to lending rates is important for us to consider. As we discuss in Section 3.6, we want to better understand how different assumptions could change our cost benefit analysis and we welcome feedback from deposit takers on our estimates for the lending rate impacts of capital. We have included a range of estimates for lending rate impacts in our cost benefit analysis (**CBA**).

Standardised deposit takers supported lower and more granular risk weights for corporate and agricultural lending and argued for the removal of Additional Tier 1 (**AT1**) capital instruments. Both issues are within scope of the current review and are discussed further in Chapters 4 and 5.

Box C: Interaction between competition and capital

Competitive dynamics in the deposit-taking sector are influenced by various factors, including prudential settings such as capital requirements. We support efforts to advance competition and innovation and take part in these efforts as a prudential regulator, alongside other agencies and the industry itself.

Structural factors are a key barrier to increased competition in banking

The Commerce Commission market study into personal banking services highlighted structural and behavioural factors which inhibit competition, both among existing entities and from new entrants. Our assessment of these factors is summarised below.

Economies of scale and scope

Group 1 deposit takers (“the major banks” in the Commerce Commission market study) enjoy significant cost advantages. Their fixed costs – such as technology and risk management systems – can be spread across a much broader customer base and business lines. Operating across a range of lending and deposit markets also diversifies their risk profile and income sources, contributing to lower funding costs. These economies allow them to offer more competitive loan pricing and maintain higher profitability than smaller entities. In our view, addressing these structural factors is the most direct way to advance competition.

Customer inertia and brand trust

High levels of consumer inertia are observed both in lending and deposit taking. Many customers remain with their deposit taker for long periods, even when better offers exist elsewhere. The inertia can be attributed to many factors including familiarity with long-established brands and service bundling. These behavioural factors give incumbent deposit takers advantages in both revenue and new customer generations as well as access to low-cost funding through interest rate-insensitive deposits. In our view, efforts

35 These estimates were provided in response to written questions sent to all banks by the FEC in December 2024. To read the written submissions made on the inquiry, see New Zealand Parliament. (2025). *Submissions and Advice*. <https://www.parliament.nz/en/pb/sc/submissions-and-advice/>.

36 Reserve Bank of New Zealand. (2019). *Capital Review: Regulatory Impact Assessment and Cost-Benefit Analysis 2019*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-cost-benefit-analysis.pdf>

to reduce barriers to switching deposit takers and progress on open banking will assist in improving competition, both among incumbents and through supporting the growth of new entrants.

Impediments to innovation by new entrants

Lack of disruptive competition is observed both among incumbent banks and from outside entrants. For example, the participants in the Exchange Settlement Account System (**ESAS**) currently largely comprise financial institutions such as the commercial banks. We recently reviewed the ESAS access policy and criteria and broadened access for non-bank entities that can meet robust requirements (for example, payment service providers and e-money institutions). The new settings also treat licensed NBDTs and registered banks consistently for the purposes of the ESAS access policy and criteria.³⁷

Capital settings are only a small piece of the competition puzzle

The Commerce Commission market study also highlighted the Reserve Bank's regulatory settings as barriers to competition, particularly to entry and expansion. However, in our view, these are only small pieces of the competition puzzle.

When deposit takers set lending rates on which they compete with each other, they consider a wide range of factors which include:

- Funding costs for a loan (for example, wholesale interest rates), which can vary over time depending on funding sources.
- Operating costs (for example, staff and IT costs). These can be higher for business lending than residential mortgage lending due to the individualised customer relationship management.
- Expected losses (for example, an allowance to cover losses expected on average, during typical conditions).
- Unexpected losses, which are those that occur from a particularly severe economic downturn or on unanticipated problem with the lending. This component is influenced by both the individual deposit taker's risk stance and the Reserve Bank's capital settings.

Our 2024 Bulletin article³⁸ found that the lending rate differences between deposit takers cannot be explained only by differences in capital settings. The article found wide differences in loan pricing between categories with similar risk weights applied to them. For example, in June 2024 large corporate loans and loans to small and medium enterprises (**SMEs**) had similar average risk weights in the Internal Ratings-Based (**IRB**) approach (57% and 55% respectively), but average contracted interest rates were 6.5%

37 For more information about the new ESAS access policy and criteria see Reserve Bank of New Zealand. (2025). *Who can use ESAS*. <https://www.rbnz.govt.nz/payments-and-settlement-systems/exchange-settlements-account-system/who-can-use-esas>.

38 Cassino, E., & Lilly, C. (2024). How risk weights affect bank lending. *Reserve Bank of New Zealand Bulletin*, 87(6). <https://www.rbnz.govt.nz/hub/publications/bulletin/2024/how-risk-weights-affect-bank-lending>

and 12.2%. These illustrate that loan pricing reflects a far wider range of factors than regulatory capital settings.

We are proposing more granular risk weights for the standardised approach

As part of regulatory settings, the Commerce Commission market study pointed out that differences between the IRB approach and the standardised approach may have impacts on competitive dynamics.

IRB banks are required to have advanced risk-modelling capabilities for measuring risks accurately. Typically, this results in IRB banks holding lower capital for some exposures than standardised banks. However, the operational and compliance costs for IRB banks to meet the capability requirements are significant and ongoing. The actual difference in funding costs is also very small after accounting for additional capital buffers imposed on Group 1 banks.

In this Consultation Paper, we have proposed more granular risk weights for the standardised approach to reflect risks more accurately (see Chapter 5). We have also announced the reduction of the minimum capital requirement for deposit takers from \$30 million that is currently required for a registered bank, to \$5 million for a deposit taker in the Summary of Submissions and Policy Decisions for the Capital Standard document published alongside this consultation.

New Zealand-specific risk factors are largely unchanged

In the 2019 Capital Review, we explicitly set out to be more conservative than other countries because of our assessment of some of the key risk factors New Zealand faces.³⁹ In this section, we have considered whether those factors remain the same or if they have changed over this time – and what this implies for the calibration of capital requirements.

There have been declines in risk in some areas that could support lower capital requirements, such as a reduction in New Zealand deposit takers' reliance on wholesale debt markets. But there are also offsetting increases in risk in other areas, such as the global macroeconomic environment and the Crown's fiscal position, that would support holding or increasing the capital requirements.

Overall, most factors have not seen a material change.

New Zealand's reliance on deposit taker-intermediated funding remains unchanged

New Zealand's financial system relies heavily on funding via traditional deposit-taking intermediaries. Large businesses may also obtain equity or debt financing from public capital markets. Smaller firms are relatively less able to access public markets, partly due to high compliance costs. Private capital financing, from private equity and private credit funds, is a more limited source of finance available for some firms.

³⁹ See paragraph 85 in Reserve Bank of New Zealand. (2017). *Issues Paper: Review of the Capital Adequacy Framework for locally incorporated banks*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/capital-review-issues-paper-may2017.pdf>.

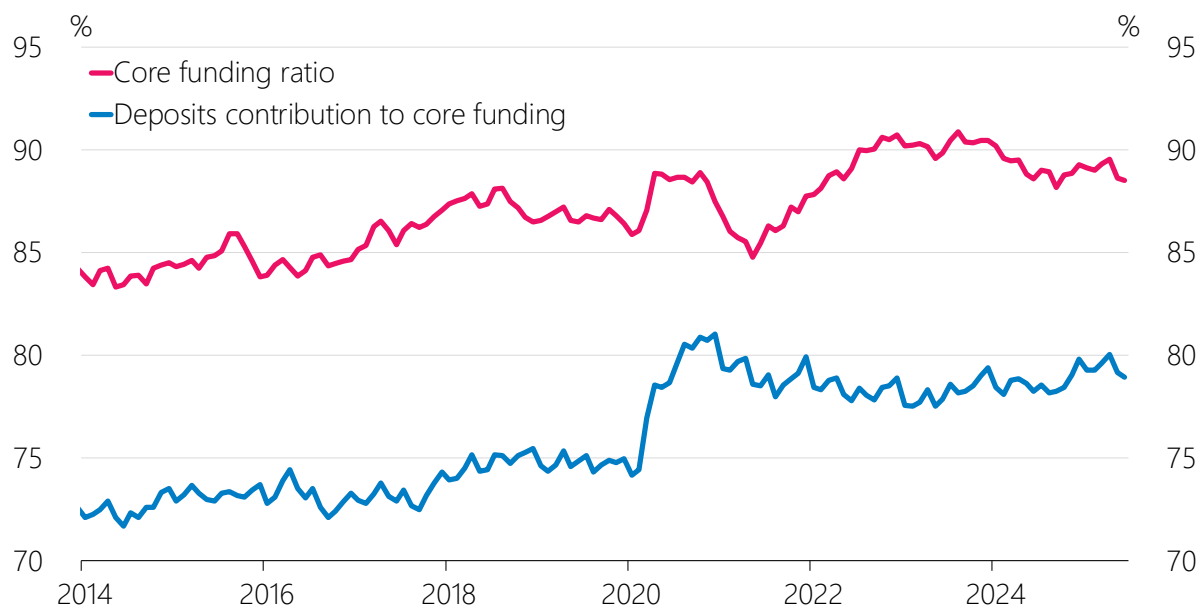
Reliance on deposit takers for credit supply exposes New Zealand's economy to risks if deposit takers face funding stress from disruptions in global markets. However, there has been broadly no change in the ratio of bank credit to gross domestic product (GDP) and few alternatives to the established deposit takers have developed since 2019, so we consider that this risk has not changed.

Deposit takers' reliance on wholesale debt markets has reduced, reducing risk

New Zealand deposit takers have historically been heavily reliant on wholesale debt markets, with a significant portion of this debt borrowed from overseas.

Figure 7 below shows that the share of core funding coming from deposits has materially increased for New Zealand deposit takers since 2019. Therefore, the net foreign liabilities in New Zealand's banking system have declined. In addition, regulatory measures and longer loan maturities have reduced overall financial sector vulnerability. Reliance on overseas wholesale debt is also less risky than it was during the Global Financial Crisis (GFC).⁴⁰

Figure 7: Average core funding ratio for New Zealand deposit takers and contribution of deposits to this ratio over time

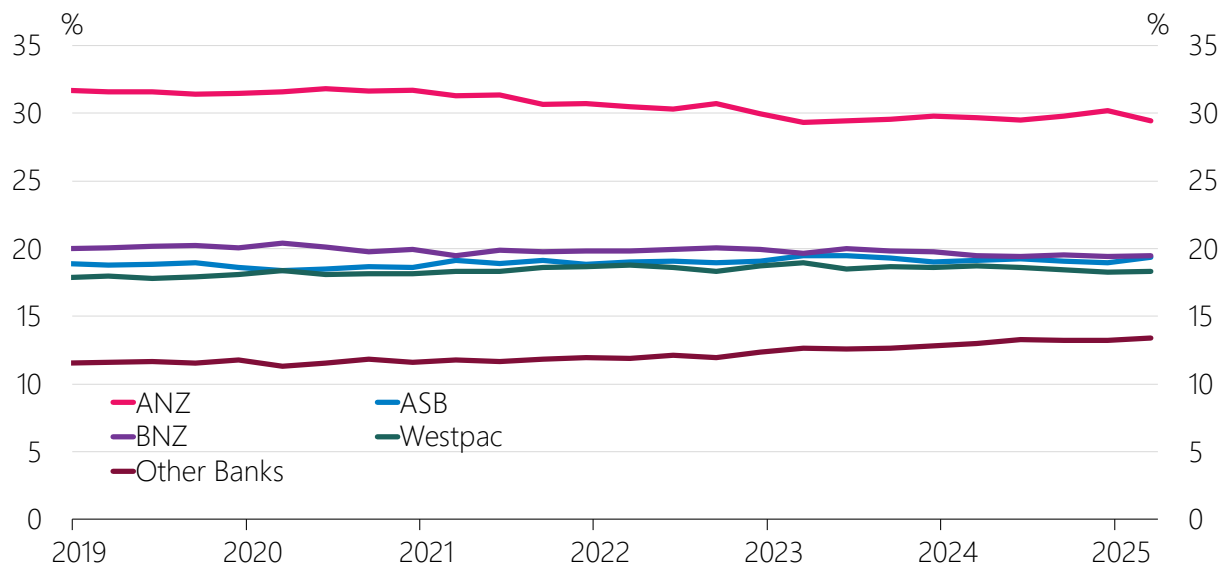


Source: RBNZ Liquidity survey.

The concentration of banking sector into a few key firms has not changed

The industry is still heavily concentrated in the four Group 1 deposit takers. Figure 8 below shows that Group 1 deposit takers maintain over 85% market share which has been largely stable over time.

⁴⁰ See special topic 2.1 in Reserve Bank of New Zealand. (2025). *Financial Stability Report: May 2025*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/financial-stability-reports/2025/may/financial-stability-report-may-2025.pdf>.

Figure 8: New Zealand banks' market share (all assets) over time

Source: RBNZ Bank Balance Sheet survey.

Fiscal headroom has declined, increasing risk

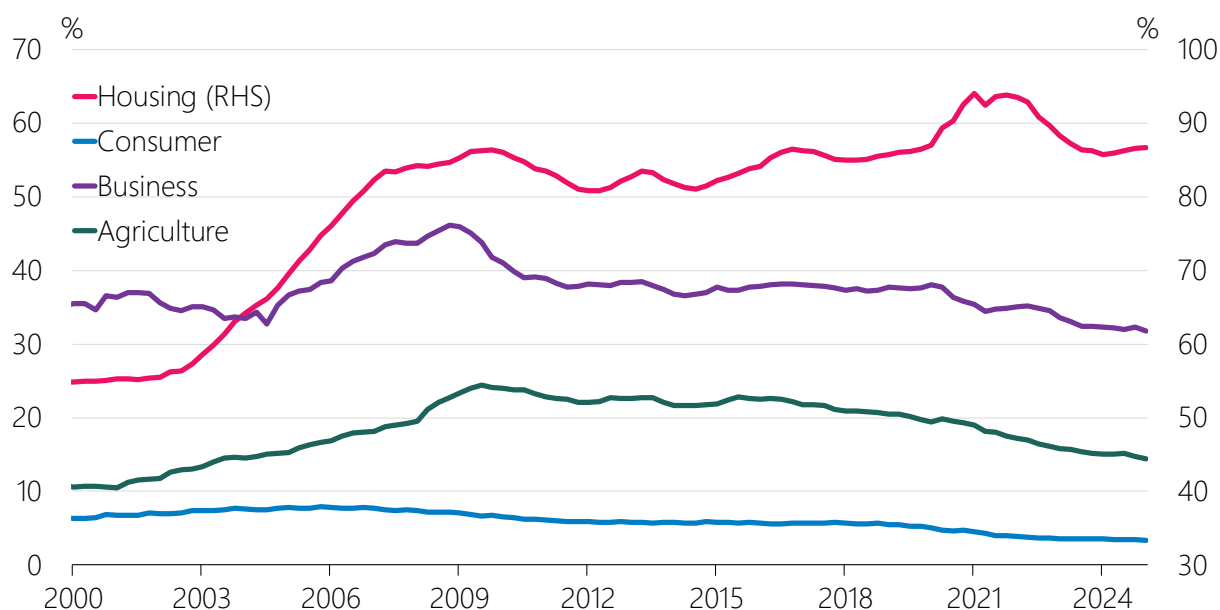
Government net debt has gone from near zero in 2018/19 to a forecast 26% of GDP in 2028/29 – however, this remains low by international standards. The operating balance structural deficit and pressures on the fiscal position are expected to grow over the medium-term, primarily due to an ageing population. This may limit the ability of future governments to intervene during a financial crisis.

This is partly offset by New Zealand's robust legal framework for fiscal sustainability, and the introduction of the DCS (discussed in Table 3 above) which shifts the cost of protecting covered depositors from the Crown to the deposit-taking sector through levies. New provisions in the DTA also act to partly mitigate the risk to public funds. These include a power for levies to be made in certain circumstances to recover from industry any Crown expenses or capital expenditures incurred in dealing with a distressed deposit taker.⁴¹

Concentration of deposit takers' portfolios has not materially changed

The main change since 2019 is a slight increase in residential mortgage lending relative to other types of lending. The other main types of lending (consumer, business and agriculture) have slightly declined as a percentage of GDP. The value of housing lending relative to GDP has slightly increased, but the largest increase in the share of housing lending was pre-2019, with a bump over the COVID-19 period which has now largely gone back to a similar number as in 2019 (see Figure 9 below).

⁴¹ We note that for these purposes "Crown expenses or capital expenditures" do not include costs incurred by the DCS, which are recovered under the separate DCS levy.

Figure 9: Credit by sector as a percentage of GDP

Source: RBNZ Bank Balance Sheet survey, Non-bank Standard Statistical Return survey, Stats NZ, RBNZ estimates.

Risks in the macro environment have increased since 2019

Financial stability risks stemming from the macroeconomic environment have generally increased since 2019, as evidenced by a review of key themes from recent Financial Stability Reports. Key global trends such as rising geopolitical tensions, protectionist sentiments, physical and transition impacts of climate change, and the COVID-19 pandemic have contributed to greater uncertainty for the financial system. We are witnessing more frequent shocks, including military conflicts and tariff measures. Concerns about fiscal sustainability in major economies and potential asset price overvaluations have further eroded investor confidence.

Collectively, these developments are amplifying risks for the New Zealand economy and financial system, with implications for exporter and business profitability, labour market resilience, bank funding costs, and the debt servicing capacity of domestic borrowers. Annex D provides more details of our assessment.

Capital is one of the key means through which we are able to proactively protect the financial system from these risks. The increase in these risks since 2019 would suggest slightly higher capital requirements, all else being equal.

We also note there are independent international assessments of how risks faced by different banking systems compare. In particular, S&P Global Ratings produce an annual Banking Industry Country Risk Assessment (**BICRA**) for many countries. In their 2025 BICRA, S&P consider New Zealand to have slightly higher industry risk than countries such as the United Kingdom, slightly higher economic risk than countries such as Ireland – and higher risk against both categories than countries such as Australia, Canada and Singapore.⁴² The higher risk for New Zealand appears to relate in particular to economic imbalances and the banking system remaining materially reliant on

⁴² S&P Global. (2025). *Banking Industry Country Risk Assessment Update: July 2025*. <https://www.spglobal.com/ratings/en>. Available by subscription only.

external borrowing. This tends to corroborate our view that some risks that New Zealand faces are relatively elevated.

Lessons from the 2023 bank failures

The 2023 bank failures in Switzerland and the United States were the first significant test to the international crisis management framework established in the aftermath of the GFC. These failures provided several lessons for prudential regulators. In particular, these recent crises emphasised significant challenges around crisis management and executing bail-in, and highlighted the general need for robust capital settings. These and other key lessons that are relevant for this Review are summarised in Table 4.

Table 4: Implications from the 2023 banking turmoil

International event	What happened	Lessons for New Zealand
2023 Credit Suisse crisis ⁴³	In 2023, Credit Suisse faced a major loss of confidence, leading to large withdrawals from clients, and a risk of collapse by mid-March. The Swiss Regulator (FINMA) ordered the full write down of its AT1 capital because the government provided emergency support, as allowed under the AT1 capital instrument's terms. The decision surprised many as AT1 holders lost their entire investment while shareholders kept some value, reversing the usual order of losses. Credit Suisse had a bail-in resolution plan to manage a failure. However, Swiss authorities instead arranged a takeover by UBS, avoiding formal resolution.	The departure from the planned resolution strategy highlights the importance of flexibility in crisis management frameworks, as well as the highly complex – and untested – nature of a full bail-in strategy (which for a variety of reasons was not implemented in this situation). When considering the potential role of LAC in New Zealand as part of the Review, this case highlights the uncertainties (including signalling effects) around bail-in instruments and emphasises the need for robust CET1 requirements. Our current AT1 and Tier 2 instrument requirements prohibit the inclusion of contractual convertibility or write down features. If contractual contingency features are included in Tier 2 or LAC in future, careful consideration should be given to the contractual terms.
2023 failure of First Republic Bank, Silicon Valley Bank, and Signature Bank in the United States	A key factor in these failures was unrealised losses in the banking book. For Silicon Valley Bank, this was mainly in bonds that had lost value due to interest rate increases. For First Republic Bank, it was a combination of securities and loans that had lost value.	New Zealand has a Pillar 1 capital requirement for interest rate risk in the banking book. Therefore, unlike United States banks, all New Zealand deposit takers hold capital against this risk. The failure of First Republic Bank highlighted the importance of adequate capitalisation in maintaining depositor confidence. This suggests that, if we

⁴³ For further details see:

- Federal Department of Finance. (2024). *UBS takeover of Credit Suisse*. <https://www.efd.admin.ch/en/credit-suisse-en>
- FINMA. (2023). *FINMA provides information about the basis for writing down AT1 capital instruments*. <https://www.finma.ch/en/news/2023/03/20230323-mm-at1-kapitalinstrumente/>
- FINMA. (2023). *FINMA publishes report and lessons learned from the Credit Suisse crisis*. <https://www.finma.ch/en/news/2023/12/20231219-mm-cs-bericht/>

International event	What happened	Lessons for New Zealand
		introduce LAC, requirements should be set such that there is sufficient LAC to adequately recapitalise a deposit taker.

- Q4** Do you have any feedback on our assessment of the new evidence since 2019?
- Q5** Is there other new evidence not discussed in this section that we should be considering?

2.3 International context

As indicated in the Terms of Reference, the scope of this Review includes an assessment of how our capital settings compare internationally and a consideration of whether our capital settings are appropriate, given the risks that the New Zealand financial system faces. In this section we discuss the conclusions from an independent report benchmarking our capital requirements. This report has been published on our website.⁴⁴ We consider the lessons from this for our capital requirements and alternative options further in Chapter 3.

Oliver Wyman report comparing New Zealand capital ratios to international peers

We commissioned Oliver Wyman to produce an independent report comparing capital ratios for New Zealand's five largest registered banks (ANZ, ASB, BNZ, Westpac, Kiwibank) to major banks in a set of peer countries. While most developed countries base their capital requirements on the Basel III framework, they may make variations to reflect specific features of their financial system.

This analysis considers capital ratios on an internationally comparable basis, once they have been adjusted for variations from the Basel Framework. Oliver Wyman's report focuses on the factual question of how capital levels compare across countries; it did not consider the rationale for regulatory differences, nor the appropriateness of capital settings for New Zealand.

The New Zealand Bankers' Association (**NZBA**) published a similar report in 2017, and an updated version in 2019, during the 2019 Capital Review. The Oliver Wyman analysis takes broadly the same approach as the NZBA reports. Comparing regulatory capital ratios across countries is inherently complex and subject to several limitations seen in both the Oliver Wyman and NZBA reports. Section 1.2 of the Oliver Wyman report has further details on the methodology and limitations.

Calculations in the report are based on banks' current capital ratios, taken primarily from their most recent Disclosure/Pillar 3 statements. Comparing actual capital ratios, rather than just Pillar 1 capital requirements, captures the broader capital framework including 'softer' regulatory overlays. For example, many countries implement Pillar 2 requirements, which focus on supervisory review

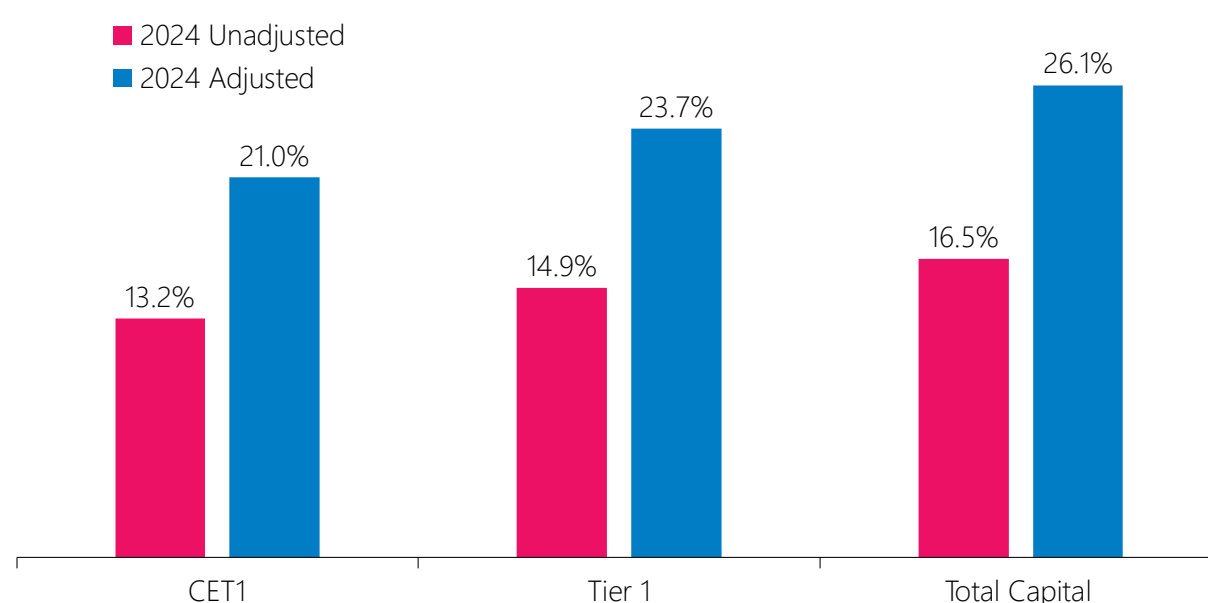
⁴⁴ Oliver Wyman. (2025). *Comparing New Zealand Bank Capital Ratios To International Peers*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/capital-review/2025/oliver-wyman-rbnz-capital-review.pdf>

and ensuring banks have sufficient capital to manage all risks, including those not specifically covered by Pillar 1. New Zealand does not have Pillar 2 requirements.

Capital and broader loss absorbency

While New Zealand's capital framework is generally consistent with Basel III, there are some areas where our rules are more conservative. This means the reported capital ratios for New Zealand's major banks would be higher if they were calculated under a more direct implementation of the Basel III framework. Current CET1 ratios are estimated to be around 780 basis points higher when they are adjusted for these differences.⁴⁵ The adjusted Tier 1 and total capital ratios (**TCRs**) for the five major New Zealand banks are also significantly higher than their currently reported ratios, as shown below in Figure 10.

Figure 10: Adjusted and unadjusted capital ratios for the five largest New Zealand banks in 2024



Source: Oliver Wyman report *Comparing New Zealand Bank Capital Ratios to International Peers*.

Around 80% of the adjustments to the capital ratios for New Zealand's major banks are driven by our more conservative rules for calculating RWAs using the IRB approach compared to Basel Standards. Firstly, the 1.2 scalar and 85% output floor that overlay IRB-modelled RWAs are higher than specified in Basel III. Secondly, we have more conservative rules for the IRB models themselves (especially relating to farm and residential mortgage lending). Smaller adjustments (about 20% of the total) are made for New Zealand's narrower definition of qualifying capital and the treatment of market risk. The adjustments are explained further in Exhibit 9 of the Oliver Wyman report.

As discussed in Chapter 5, we are proposing lower and more granular standardised risk weights for certain lending types. These changes would bring New Zealand more in line with the Basel

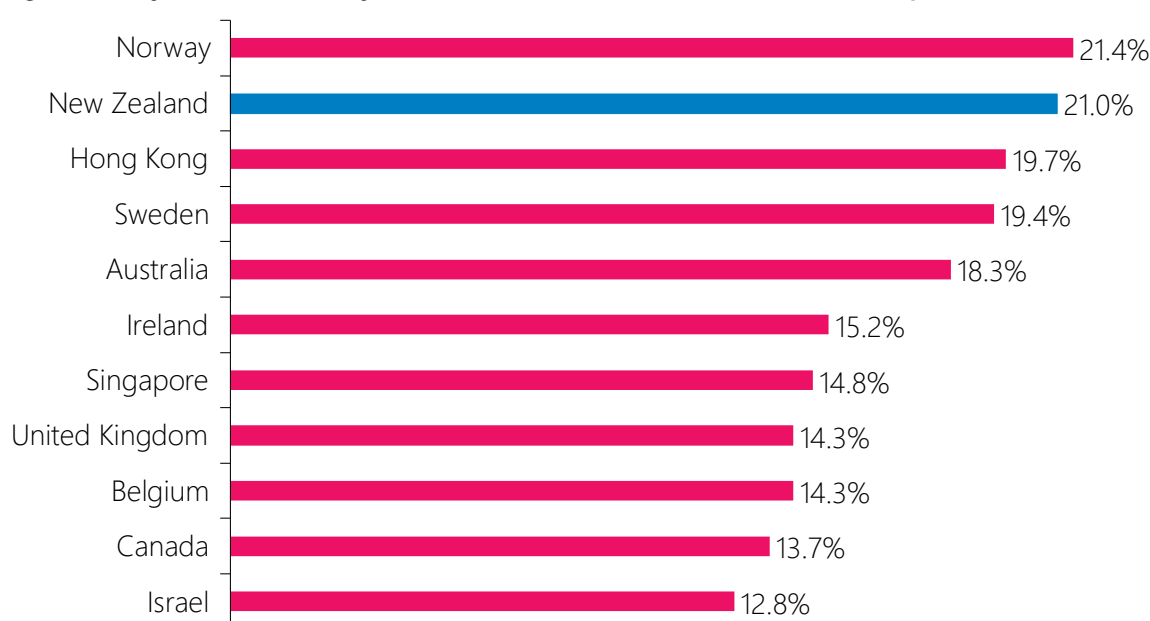
⁴⁵ New Zealand capital ratios are the average ratios of the five largest banks (ANZ, ASB, BNZ, Westpac, and Kiwibank), weighted by RWAs. Chapter 5 of this document sets out proposals for changes to risk weights in New Zealand. The analysis presented here is based on current risk weights, but we estimate that these proposals would reduce the adjusted CET1 ratio by around 70 basis points.

Framework, reducing the difference between the adjusted and unadjusted current capital ratios for the five major New Zealand banks.

The set of comparator countries includes Australia, Canada, Hong Kong, Singapore, Israel, the United Kingdom, Belgium, Sweden, Ireland, and Norway.⁴⁶ For each country, Oliver Wyman has identified material variations in their capital rules from the Basel III framework and recalculated the reported capital ratios for the major banks using Basel rules.⁴⁷ Most countries, except Australia, have relatively small adjustments to their capital ratios compared to New Zealand.

Capital ratios for New Zealand's five largest banks are relatively high on an internationally comparable basis. As shown in Figure 11, the adjusted CET1 ratio for these banks is currently higher than all other comparator countries except Norway, although the difference between Norway and New Zealand is small. The adjusted TCR for the five major New Zealand banks is also currently higher than all other comparator countries except Australia (Figure 12).

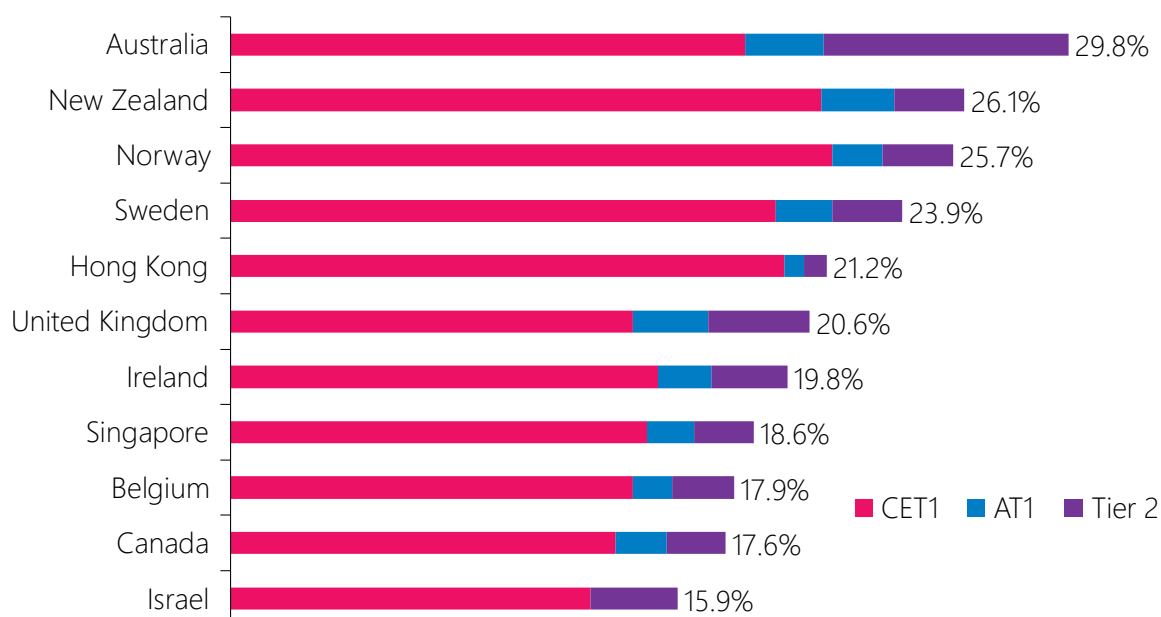
Figure 11: Adjusted current major bank CET1 ratios in New Zealand and comparator countries



Source: Oliver Wyman report *Comparing New Zealand Bank Capital Ratios to International Peers*.

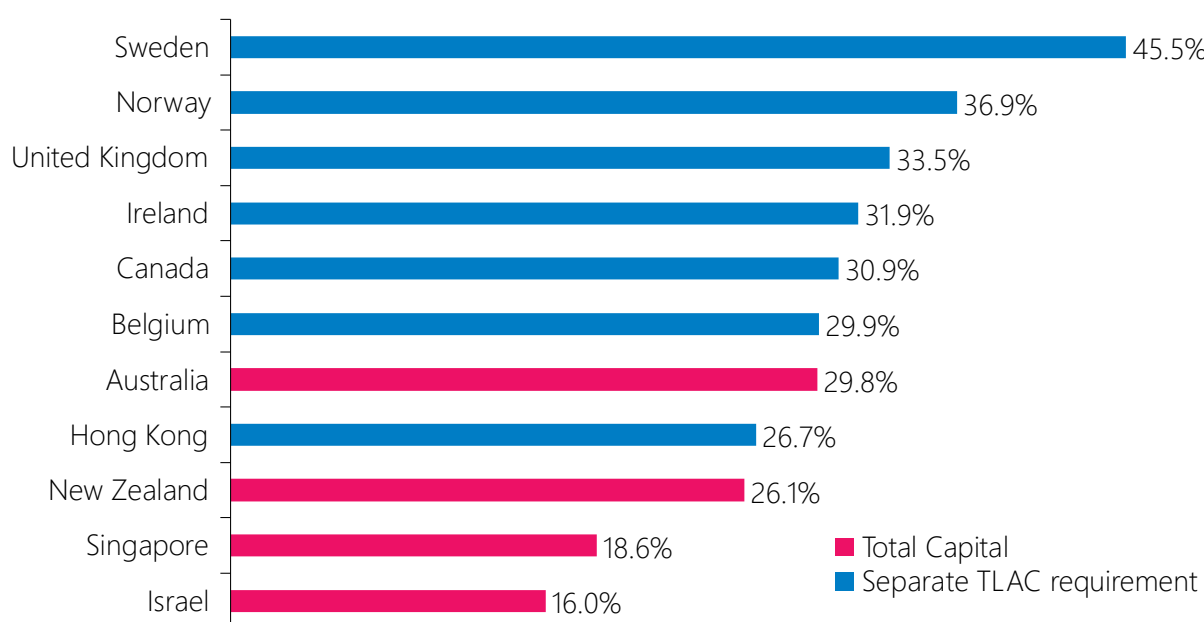
⁴⁶ For an explanation of how Oliver Wyman chose this set of comparator countries, see page 28 in Oliver Wyman. (2025). *Comparing New Zealand Bank Capital Ratios To International Peers*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/capital-review/2025/oliver-wyman-rbnz-capital-review.pdf>

⁴⁷ Comparator country capital ratios are the average of major banks, weighted by RWAs, with major defined as having more than 10% market share.

Figure 12: Adjusted current major bank TCRs in New Zealand and comparator countries

Source: Oliver Wyman report *Comparing New Zealand Bank Capital Ratios to International Peers*.

Most of the comparator countries (excluding Australia, Singapore, and Israel) have requirements for additional loss-absorbing instruments over and above the capital stack (see Section 2.1 for a discussion of LAC). These requirements are not currently part of New Zealand's regulatory framework. The report therefore adjusts TLAC ratios for banks in countries with these additional buffers to consider how the broader loss-absorbing capacity compares with the five major New Zealand banks. As shown below in Figure 13, the TCR for New Zealand's five major banks is currently lower than the TLAC ratios for major banks in comparator countries that have these additional requirements.

Figure 13: Adjusted current major bank TLAC (or total capital) ratios in New Zealand and comparator countries

Source: Oliver Wyman report *Comparing New Zealand Bank Capital Ratios to International Peers*.

These results suggest that New Zealand's current capital requirements are relatively high on an internationally comparable basis. They are not necessarily inconsistent with international peers, and indeed, they are lower than average on some metrics. Adjusted capital ratios are currently higher than most comparator countries, but the five largest New Zealand banks are towards the lower end of comparator countries in terms of overall loss-absorbing ratios.

2028 capital ratios

The report also considers how New Zealand's capital requirements would compare in 2028, if the 2019 Capital Review decisions were fully implemented. To do this, the report assumes that capital ratios for New Zealand's five largest banks will increase from current levels as requirements increase. However, it also assumes that management buffers (i.e., the difference between actual and required capital ratios) will be smaller in 2028 than they are currently, reflecting that banks have frontloaded some of the upcoming increases.

Oliver Wyman have not adjusted ratios for peer countries for any change to capital rules that are yet to be implemented but which may increase capital requirements. This could overstate comparisons of New Zealand's forecast 2028 ratios.

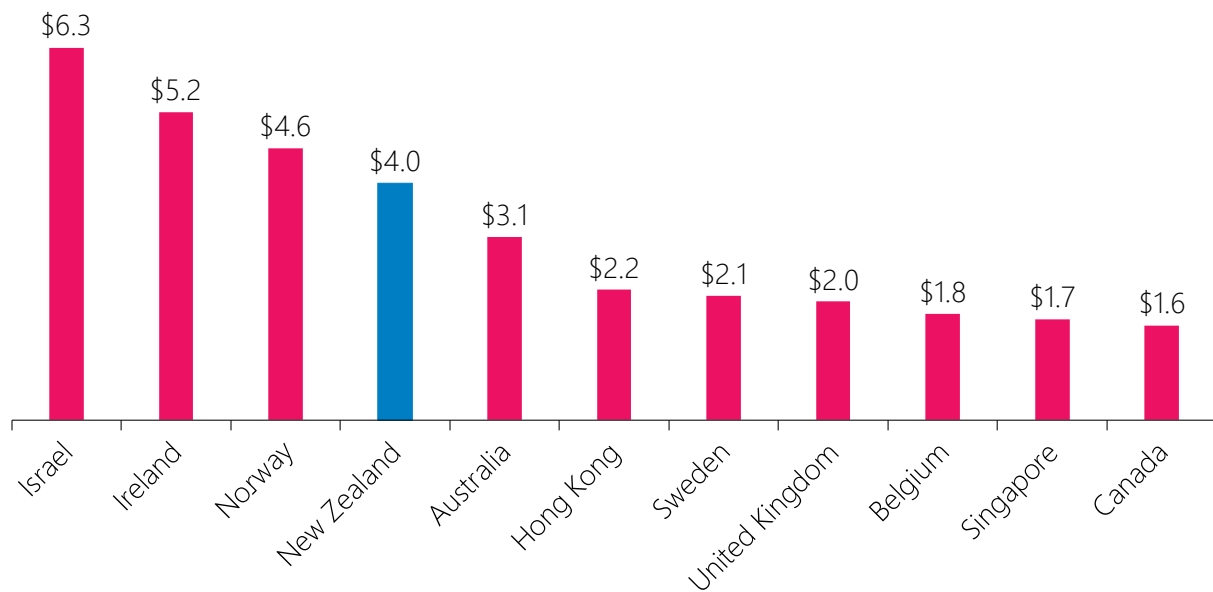
Based on the 2028 projections, New Zealand's five largest banks would have higher adjusted CET1 and total capital ratios than currently seen in any of the comparator countries. Their projected TCR is slightly higher than the major Australian banks currently, placing New Zealand around the middle of the comparator countries in terms of total loss absorbency. However, other countries may implement changes to capital rules over the next three years that affect these comparisons.

This Consultation Paper seeks feedback on two possible options to change capital settings. In Section 3.5, we estimate how these options would compare with comparator countries and with capital ratios in 2028 if the 2019 Capital Review decisions were fully implemented. This analysis considers the impacts of the proposed changes to the form and amount of capital, and the proposed changes to risk weights discussed in Chapter 5.

Actual capital per dollar of lending

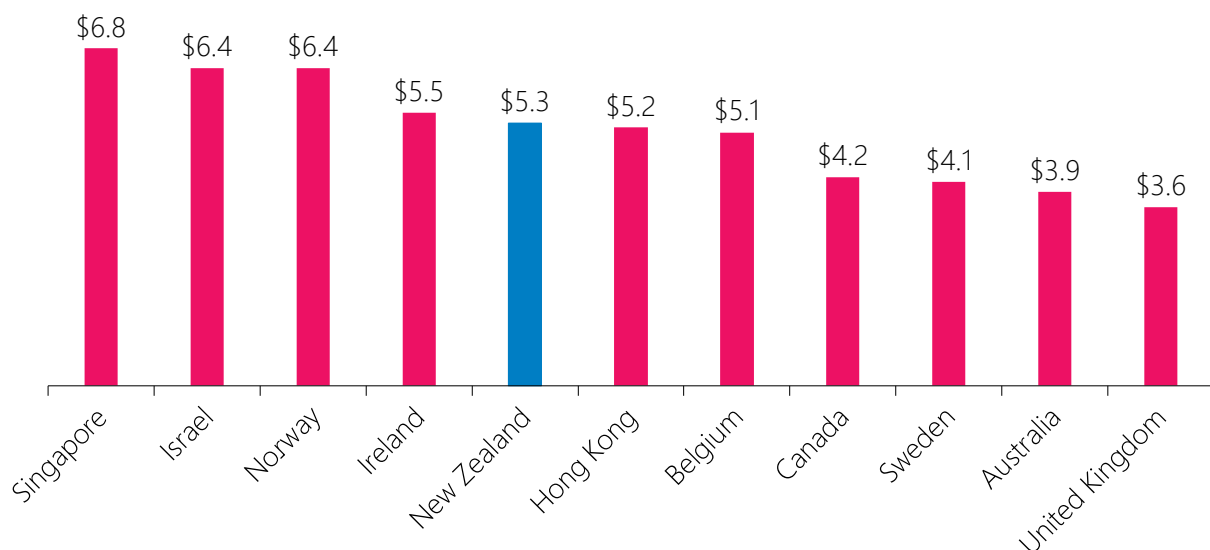
An alternative way to compare how well capitalised banks are is to calculate the amount of capital they have against their lending. For New Zealand and the comparator countries, Oliver Wyman have calculated 'capital coverage ratios' showing how much capital major banks have per \$100 of retail and non-retail lending. Figures 14 and 15 below show that the five major New Zealand banks have relatively standard amounts of CET1 capital for retail and non-retail lending, despite having one of the highest adjusted CET1 ratios.

Figure 14: Capital coverage ratios for retail lending for New Zealand and comparator countries



Source: Oliver Wyman report *Comparing New Zealand Bank Capital Ratios to International Peers*.

Figure 15: Capital coverage ratios for non-retail lending for New Zealand and comparator countries



Source: Oliver Wyman report *Comparing New Zealand Bank Capital Ratios to International Peers*.

This may seem like a contradiction to the findings above and understanding it is important to the report's interpretation. Capital coverage ratios capture differences in the underlying risk profile of each bank's assets, which might be driving some of these differences. However, they also capture layers of conservatism that can be added even when the rules are the same as Basel and therefore do not affect adjusted capital ratios. For example:

- Standardised risk weights tend to be higher than IRB-modelled risk weights. Countries with a high proportion of exposures that are modelled using standardised approaches (such as Israel) will have, on average, higher risk weights.

- Countries with significant historical losses (such as Ireland) will have higher modelled losses and therefore require higher risk weights.
- Regulators may only accredit IRB models if they are sufficiently conservative to satisfy implicit risk appetites, resulting in higher risk weights.

These variations will mean banks have more capital for their lending, but the impacts will not be quantified in adjusted capital ratios as there are no explicit regulatory differences from the Basel Framework. Instead, impacts will be captured in capital coverage ratios.

Most credit risk in New Zealand and Australia is modelled using the IRB approach. Visible differences in the modelling approaches compared to Basel have been quantified (including the scalar and standardised floor) for New Zealand's IRB banks and contribute most of the capital ratio adjustments. Capital ratios for Kiwibank, who are the only New Zealand bank in the sample not to use the IRB approach, have also been adjusted for conservative standardised risk weights compared to Basel. This can make adjusted capital ratios for major New Zealand and Australian banks look higher than in other countries. However, on average, as shown above, they appear to have much more standard amounts of capital per dollar of lending.

Comparisons to a broader set of countries

The report also compares the five major New Zealand banks to a broader set of international banks. The comparison set is from the March 2025 Basel III Monitoring report,⁴⁸ which includes data for 176 global Basel Group 1 (internationally active banks with Tier 1 capital of more than €3 billion) and Basel Group 2 banks (all other banks). A limitation of using a sample of this size is that it is not possible to adjust all capital ratios to an internationally consistent standard, so the report compares New Zealand's adjusted ratios to other banks' unadjusted ratios.

The adjusted CET1 ratio for the five largest New Zealand banks is in the top quartile of unadjusted Basel Group 1 banks, and in the 50th-75th percentile of unadjusted Basel Group 2 banks. Results are broadly similar when comparing Tier 1 and total capital ratios.

Although New Zealand's domestic systemically important banks (**D-SIBs**) meet the definition of Basel Group 1 banks, they are much smaller than average for that group. Basel Group 1 includes very large Global Systemically Important Banks (**G-SIBs**), which are less comparable to New Zealand banks. While Basel Group 2 banks are smaller, they are, on average, closer in size and arguably more comparable to New Zealand's locally focused D-SIBs. New Zealand banks are currently well within a 'normal' range for Basel Group 2 banks. Capital ratios in 2028 would be in or near the upper quartile of Basel Group 2 banks based on the projections.

The results of this report show that New Zealand's CET1 and total capital requirements would be strict relative to international peers in 2028 if the 2019 Capital Review decisions are fully implemented. However, the lack of additional loss absorbency requirements would be somewhat unusual and leave TLAC ratios more typical of peer countries. These factors have influenced the design of the options presented in Chapter 3.

48 Basel Committee on Banking Supervision. (2025). *Basel III Monitoring Report: March 2025*. <https://www.bis.org/bcbbs/publ/d592.pdf>

Q6

Do you have any feedback on this analysis of how New Zealand deposit takers' current and planned capital levels compare to other jurisdictions?

3 Capital stack options

As discussed in Section 1.4, this Consultation Paper seeks feedback on capital stack options calibrated to a higher risk appetite than in 2019. Under the Reserve Bank of New Zealand Act 2021, the Reserve Bank now has a Board who are responsible for determining the risk appetite for various regulatory outcomes – including capital settings. A key reason for the change in risk appetite is that under the Deposit Takers Act 2023 (**DTA**) (once fully implemented), we will have more comprehensive tools for supervision and crisis management.

This chapter sets out two options for the appropriate amount, form and distribution of capital for New Zealand, based on the approach described in Section 1.3.

This Consultation Paper does not set out a preferred option. At this stage of the Review, we are seeking stakeholder feedback on these options and our preliminary analysis of their costs and benefits. We are open to consideration of alternatives to these two options.

Both options continue to promote financial system stability and the safety and soundness of individual deposit takers, however they are likely to reduce the cost of regulation compared to the 2019 framework. One option follows a similar form of capital to our current requirements but reduces the amount. The other adjusts the form of capital by introducing additional Loss-Absorbing Capacity (**LAC**).

Both options assume we proceed with the phase out of Additional Tier 1 (**AT1**) capital and changes to risk weights under the standardised approach, as described in Chapters 4 and 5, respectively. The proposed changes to risk weights materially reduce the amount of capital required for a given capital ratio requirement.

The two options consist of proposals for each group of deposit takers – determining the distribution of capital. We have approached the calibration of capital requirements within each of these option sets by focusing on the different groups of deposit takers, reflecting their different levels of systemic importance. The two options have different settings for Group 1 deposit takers, but both options have the same requirements for Group 2 and Group 3 deposit takers.

This chapter covers:

- options for feedback for Group 1 deposit takers (Section 3.1);
- a proposal for feedback for Group 2 deposit takers (Section 3.2);
- a proposal for feedback for Group 3 deposit takers (Section 3.3);
- proposals for the Counter-Cyclical Capital Buffer (**CCyB**) (Section 3.4);
- an assessment of the options and proposals against our assessment criteria (Section 3.5); and
- a summary of our cost benefit analysis (**CBA**) (Section 3.6).

3.1 Options for Group 1

For Group 1, we have considered the amount and form of capital needed in these deposit takers to achieve a level of resilience for the financial system as a whole, consistent with our risk appetite (as discussed in Section 1.4).

We have formulated two potential options for Group 1 deposit takers, with different emphases on going and gone-concern capital (see Table 5 below).

Table 5: Summary of options for Group 1

	Status Quo: 2019 Capital Review decisions – once fully implemented in 2028 (% of RWA)	Option 1: No LAC (% of RWA)	Option 2: LAC (% of RWA)
Minimum Common Equity Tier 1 (CET1)/Tier 1 capital	7 Of which, at least 4.5 CET1, and up to 2.5 AT1	6	6
Prudential Capital Buffer (PCB)	9	8	6
Total CET1/Tier 1 capital	16	14	12
Tier 2 capital	2	3	3
Minimum total capital	9	9	9
Total capital including PCB	18	17	15
Internal LAC	-	-	6
Total LAC	18	17	21

Option 1 has similarities to the structure of capital requirements under the decisions made in the 2019 Capital Review, with an emphasis on having a large buffer of high-quality going concern (CET1) capital, which would promote deposit takers' resilience to shocks and create headroom to recover the resilience of a deposit taker as it faces losses. Reflecting our increased risk appetite, the PCB would decrease from 9% (if all 2019 Capital Review decisions were fully implemented in 2028) to 8%. The removal of the 2.5% AT1 capital would be partly offset by an increase in Tier 2 capital by 1%. Taken together with the proposed changes in risk weights discussed in Chapter 5, this would reduce capital by around \$7 billion (around 11%) relative to the settings decided on in 2019. Total capital in 2028 would be around \$1 billion (around 2%) higher than current levels.

Option 2 takes an alternative approach, reducing the size of the PCB for Group 1 to 6%, compared with 9% in the 2019 Capital Review decisions while introducing a new requirement for deposit takers to have LAC on top of their capital stack. This LAC would be debt that can be bailed-in to recapitalise a distressed Group 1 deposit taker (see Section 2.1). Additionally, reflecting the current ownership structure of Group 1 deposit takers, we would require this LAC, as well as Group 1 deposit takers' Tier 2 capital, to be issued internally to their Australian parent bank. LAC and Tier 2 are commonly called gone concern capital internationally, but it is worth noting (as described in Section 2.1 and Box D below) that this does not mean they can only be used in a formal resolution or a wind-down of the distressed firm. While this option increases the overall loss absorbency, it is expected to reduce CET1 by around \$7 billion (around 14%) compared to the 2019 Capital Review decisions.

Box D: The nature and scope of LAC requirements for Group 1 under Option 2

Our current intention is that LAC would take a form similar to Tier 2 capital and be issued internally (to the Australian parent bank) under Option 2. We would also require the Tier 2 within the existing capital stack to be issued internally under this option. If a LAC option is adopted, we intend to carry out further consultation on the specific design of LAC instruments.

At this stage we are only considering LAC for Group 1 deposit takers. To meet the additional purposes under Part 7 of the DTA, our crisis management approach for Group 1 deposit takers will need to involve both stabilisation and recapitalisation. This is because alternative crisis management options, such as liquidation and DCS payout, would not be appropriate for Group 1 deposit takers considering their systemic importance. Such alternative options would either not be feasible or would create a prohibitive level of disruption and destruction of value.

We are not currently proposing a LAC requirement for Group 2 or Group 3 deposit takers given the nature of their business. It would be difficult for smaller deposit takers to market such instruments, and there are other recovery and resolution tools available for these deposit takers. However, we may revisit this issue at a later point for Group 2 deposit takers as part of our implementation of the crisis management framework in the DTA and development of resolution plans for deposit takers. In that event, further public consultation will be undertaken on this issue.

We note that international experience indicates there is an increased level of uncertainty around the effectiveness of LAC in stabilising and recapitalising a deposit taker in a way that would meet the additional purposes in Part 7 of the DTA (this is discussed more detail in the options analysis below).

In addition, concerns about contractual bail-in features were raised in the 2019 Capital Review, for example the cost and difficulty of effectively administering contractual bail-in and the potential ineffectiveness of going concern triggers. However, some of these concerns may not apply in relation to internally issued Tier 2 or LAC instruments, or could be mitigated via the specific design of these instruments. In particular, one of the concerns in 2019 was that capital instruments with contractual bail-in features could be issued to investors who may not fully appreciate the risks associated with those instruments (or accept those risks if and when they materialise). Having Tier 2 and LAC instruments only issued within the group materially mitigates this level of uncertainty in respect of our crisis management preparedness and operations. A requirement for Tier 2 and LAC to be internally issued also supports our preferred single point of entry (**SPE**) approach for dealing with a distressed Group 1 deposit taker.

We also anticipate that the relevant contractual bail-in terms will be largely standardised under Tier 2 and LAC instruments if this option is adopted. However, specific design features of internal Tier 2 and LAC would be subject to further consultation depending on the outcome of this Review. At this stage, we expect that these instruments would be designed in a manner consistent with Financial Stability Board and Basel Committee on

Banking Supervision (**BCBS**) guidance, subject to any necessary tailoring to reflect New Zealand circumstances.

We analyse these options against our assessment criteria in more detail in Section 3.5. Some key points that led us to select these options are:

- We engaged Oliver Wyman to conduct detailed analysis of the Reserve Bank's capital rules, relative to other countries' implementation of the Basel standards. This revealed that our CET1 levels were going to be at the high end internationally by 2028, after adjustments to harmonise reporting across countries, but on the lower end on a Total Loss-Absorbing Capacity (**TLAC**) basis. This suggests considering options with lower CET1 and options with LAC.
- As discussed in Section 3.6 and Annex E, we see potential that bail-in instruments like LAC may offer loss absorbency at a lower cost than CET1 capital at the margin, so that swapping some CET1 for a larger measure of LAC (as in Option 2) could offer net gains. However, as evidenced by the 2023 bank failures overseas, there is greater uncertainty about the effectiveness of LAC in stabilising and recapitalising a failed deposit taker in a way that would meet the Part 7 purposes under the DTA.
- As we become more orthodox in terms of our supervisory resourcing and scrutiny of firms, we may be able to address issues at those firms more forcefully and earlier.

We have not closed off consideration of alternatives to these two options, rather we have chosen to model them as illustrations of the range of possibilities. Feedback could still suggest a preference for the status quo plan, variants of Option 1 or 2, or other ideas such as hybrids of the status quo and one of the two options we have modelled.

We have identified factors that suggest options with much lower capital than Option 1 or 2 for Group 1 undesirable:

- It does not seem sensible to set our requirements below Australian requirements (for Group 1 in particular). This is because the consolidated Australian parent bank would still have to have enough capital to meet the Australian Prudential Regulatory Authority (**APRA**) rules for its New Zealand operations, and even if that capital was not in the New Zealand subsidiary, New Zealand borrowers may still be charged for the cost of it.
- While the CBA in Section 3.6 and Annex E is preliminary and we do not consider it to definitively endorse or reject Option 1 or 2, the same model shows sharply increasing costs of financial crises if capital levels are reduced much further than current levels.⁴⁹

Q7 Do you have any feedback on the two high-level options for Group 1?

Q8 Do you have any alternative proposals?

⁴⁹ As at March 2025.

3.2 Proposal for Group 2

For Group 2 deposit takers, we have considered the minimum baseline level of resilience needed in each deposit taker, and to achieve appropriate proportionality in capital requirements between the three groups of deposit takers.

Both options have the same proposal for Group 2, which feature an increased risk appetite and lower capital requirements relative to the decisions made in the 2019 Capital Review – particularly once the changes in standardised risk weights proposed in Chapter 5 are taken into account (Table 6 below). The proposed approach reflects the higher risk tolerance discussed in Section 1.4.

Table 6: Summary of proposal for Group 2

	Status Quo: 2019 Capital Review decisions – once fully implemented in 2028 (% of RWA)	Proposal for Group 2 (% of RWA)
Minimum CET1/Tier 1 capital	7 Of which, at least 4.5 CET1, and up to 2.5 AT1	6
PCB	7	5
Total CET1/Tier 1 capital	14	11
Tier 2 capital (maximum)	2	3
Minimum total capital	9	9
Total capital including PCB	16	14

This proposal includes a reduction in the PCB for Group 2 from 7% in the status quo of the 2019 Capital Review decisions to 5% in both options. Similarly, as is the case for Group 1, it removes AT1 and provides for more scope to use Tier 2 capital relative to the 2019 Capital Review status quo.

Levels of CET1 capital are estimated to fall from \$8 billion to \$7.1 billion for Group 2 once all of the changes are taken into account. For Group 2, the minimum amount of CET1 would decrease as a percentage of RWAs from 11.5% under the status quo (the 2019 Capital Review decisions) to 11%. However, due to the reduction in risk weights discussed in Chapter 5, in dollar terms the amount of CET1 would be significantly lower than the status quo.

The expected impacts of the proposal are discussed in more detail in subsequent sections of this chapter. With lower levels of capital than previously provided for in the 2019 Capital Review decisions, the proposed approach would mean less capital in those Group 2 institutions to absorb losses. This increases the risk that a Group 2 deposit taker will fail in the future.

This matches the increased tolerance for risk of entity failure. In the case of Group 2, the failure of a deposit taker may have less system wide impact compared to the failure of a Group 1 deposit taker (although it may still have serious effects, such as a serious loss of confidence in the sector). However, while the financial stability risk may potentially be lower for Group 2 relative to Group 1,

it is important that there are sufficient capital buffers in place to absorb losses and provide a sufficient runway to respond to distress.

This increased risk tolerance results in a more proportionate approach to requirements, reflecting a larger divergence in the requirements for the two groups. Nevertheless, the proportionality impacts are different relative to each Group 1 option, which are discussed in more depth below.

Q9 Do you have any feedback on the proposal for Group 2?

Q10 Do you have any alternative proposals?

3.3 Proposal for Group 3

For Group 3, as is the case for Group 2, we have considered the minimum baseline level of resilience needed in each deposit taker, and to achieve appropriate proportionality in capital requirements between the three groups of deposit takers.

Our Group 3 proposal reflects, in our view, a baseline minimum viable set of capital requirements. While the headline capital ratio requirement of 13% (or 14% with no credit rating) remains unchanged from the setting proposed in the 2024 DTA Capital Standard consultation, the changes to risk weights proposed in Chapter 5 reduce the amount of capital needed to meet these requirements.

Table 7: Summary of proposed approach to Group 3

	Proposed approach in May 2024 DTA Capital Standard Policy Consultation (% of RWA)	Proposal for Group 3 (% of RWA)
Minimum CET1/Tier 1 capital	7 (Of which, at least 4.5 CET1, and up to 2.5 AT1)	6
PCB	4 (or 5 if no credit rating)	4 (or 5 if no credit rating)
Total CET1/Tier 1 capital	11	10 (or 11 if no credit rating)
Tier 2 capital	2	3
Minimum total capital	9	9
Total capital including PCB	13 (or 14 if no credit rating)	13 (or 14 if no credit rating)

Under both options, we propose Group 3 deposit takers would be required to meet a minimum capital ratio of 9% of RWA, up to 3% of which can be made up of Tier 2 capital instruments, and a PCB of 4% of RWA, which must be CET1 capital.

After considering the feedback we received in the response to 2024 DTA Capital Standard policy consultation, we have decided to set the minimum capital level at \$5 million, at the low end of the

range that we consulted on.⁵⁰ Our assessment is that this will provide some additional support for the safety and soundness of individual Group 3 deposit takers.

We do not expect the \$5 million minimum capital level to have any meaningful negative impacts on competition. While it might restrict some very small deposit takers from entering the market if they cannot source that level of capital, such small providers are unlikely to provide any meaningful competition with larger deposit takers in practice. Further, it is significantly lower than the current \$30 million requirement for registered banks – and we are intending to consult in October 2025 on the use of the term ‘bank’ in the name or title once the DTA comes into force.

The 4% buffer is set at the lowest level that we consider to be feasible, as it would provide some time for recovery actions from a distressed Group 3 deposit taker to ensure either a recovery in capital or an orderly resolution. We consider any lower levels of buffer there would leave limited opportunity to take actions to support recovery or orderly resolution. As such the ‘runway’ available for such actions would be severely compressed at levels of buffer of less than 4%. This is magnified by the lags at which robust financial information is available. For example, by the time we are taking supervisory actions, the actual position of the deposit taker is likely to have significantly worsened beyond what is reported in its accounts.

In effect, these settings for Group 3 set the minimum level of capital requirements that we consider will meet the main purpose of the DTA.

The removal of AT1 from the capital stack for deposit takers, compared with the proposals published in 2024, would remove an option for raising capital at a lower cost than CET1. However, the additional Tier 2 capital would create some additional flexibility. We will consider how to treat existing preference shares used by non-bank deposit takers (**NBDTs**). This is similar to the issues around how to manage existing AT1 instruments that have been issued by Group 1 and 2 deposit takers, but may have additional complexity for Group 3, given their small size.

Q11 Do you have any feedback on the proposal for Group 3?

Q12 Do you have any alternative proposals?

3.4 Proposals for the counter-cyclical capital buffer

In the 2019 Capital Review we included a CCyB as part of the PCB for Group 1 and 2 deposit takers. Unlike other components of the capital stack, the CCyB is part of our macroprudential policy toolkit and is designed to be adjusted during the financial cycle to take account of the systemic risks present in the financial system.

In 2019, we also decided that the CCyB should be administered using an ‘early-set’ strategy. This means that the CCyB would be set at its long-run level of 1.5% of RWAs and it would only be reduced or removed during periods of systemic stress to encourage deposit takers to continue lending. We did not expect to raise the CCyB above its long-run level, instead relying on other tools to mitigate the build-up of systemic risk.

⁵⁰ Reserve Bank of New Zealand. (2025). *Deposit Takers Core Standards: Summary of Submissions and Policy Decisions for the Capital Standard*. https://consultations.rbnz.govt.nz/dta-and-dcs/deposit-takers-core-standards/user_uploads/summary-of-submissions-policy-decisions-capital-standard.pdf

We continue to view the CCyB as an important part of our future macroprudential toolkit. As such, we propose that the CCyB will form part of the PCB for Group 1 and 2 deposit takers. Given the size of these deposit takers, a reduction in their CCyB could meaningfully impact lending volumes during a period of systemic stress, helping to limit the overall tightening in financial conditions. However, we propose setting the long-run level of the CCyB at 1% of RWA, rather than 1.5%, to reflect that the PCB will be smaller for Group 1 and 2 deposit takers under the options proposed.

We have also considered whether the proposed PCB for Group 3 deposit takers will include a CCyB. We do not intend to apply other macroprudential tools such as restrictions on high loan-to-value ratio and high debt-to-income ratio residential mortgage lending to Group 3 deposit takers.⁵¹

Consistent with that approach, we propose to not apply the CCyB to Group 3 deposit takers. Given the small size of the Group 3 sector, the impact on aggregate lending (and overall financial conditions) would be small if we applied a CCyB to Group 3 deposit takers.

In addition, applying the CCyB to Group 3 deposit takers could also entail relatively more risk than for Group 1 and 2 deposit takers. The proposed Group 3 PCB (4%) is already lower than for either of the proposed options for Group 1 and 2 deposit takers. If the CCyB was reduced to 0%, this would reduce the Group 3 PCB to 3% and allow their regulatory capital levels to move closer to their minimum capital requirements, compared to those of Group 1 and 2 deposit takers. As a result, there would be less time available for recovery actions from a Group 3 deposit taker to ensure either a recovery in capital or an orderly resolution. Moreover, many Group 3 deposit takers are less able to increase their capital levels quickly (for example, by issuing capital instruments) compared to most Group 1 and 2 deposit takers.

Therefore, applying the CCyB to Group 3 deposit takers could potentially cause complications when we restore the CCyB back to its long-run level of 1%, whilst not having a significant effect on supporting lending during a period of systemic stress.

Q13 Do you agree with the proposal of a 1% Counter-Cyclical Capital Buffer for Group 1 and 2 deposit takers under the options proposed?

Q14 Do you agree with the proposal that the Counter-Cyclical Capital Buffer should not apply to Group 3 deposit takers?

3.5 Assessment of options

In this section, we provide an initial assessment of the options against the assessment criteria developed for this Review, based on our statutory parameters including the DTA purposes and principles that we consider most relevant for this Review (see Section 1.3). A summary of our analysis is provided in Table 8 below.

⁵¹ See Chapter 6 in Reserve Bank of New Zealand. (2025). *Deposit Takers Non-Core Standards: Summary of Submissions and Policy Decisions*. https://consultations.rbnz.govt.nz/prudential-policy/deposit-takers-non-core-standards/user_uploads/dta-non-core-standards-summary-of-submissions-and-policy-decisions.pdf.

Financial stability criteria

- **Going concern loss absorbency:** Maintain a sufficient prudential capital buffer above the regulatory minimum to absorb losses, protect and promote the stability of the financial system, and promote the safety and soundness of each deposit taker (links to DTA section 3(1) and 3(2)(a) purposes).
- **Crisis management:** Enable a distressed deposit taker to be dealt with in an orderly manner, recognising the need for a credible resolution strategy for deposit takers to promote financial stability and avoid the use of public money (links to DTA section 259 purposes).

Other criteria

- **Proportionality:** Take a proportionate approach to regulation and supervision (links to DTA section 4(a)(i) and (ii) principles).
- **Competition:** Maintain competition within the deposit-taking sector, recognising the desirability of a diverse deposit-taking sector that provides financial products and services to a diverse range of New Zealanders (links to DTA section 3(2)(c) purpose, and section 4(a) and (b) principles).
- **Funding costs:** Consider the impact on deposit takers' weighted average funding costs, which in turn affect lending rates, recognising their importance for supporting the prosperity and well-being of New Zealanders (links to DTA section 3(1) and 3(2)(d) purposes).
- **Simplicity/achievability:** Be practical to administer, easy to implement and avoid unnecessary compliance costs (links to DTA section 4(c) principle).
- **International alignment:** Align with international standards where appropriate (links to DTA section 4(d) principle).

Table 8: Summary comparison of options against the status quo of the 2019 Capital Review decisions, once fully phased in by 2028

↑↑ Substantially stronger than status quo (2028 outcomes)		↑ Somewhat stronger than status quo (2028 outcomes)		↔ Neutral	↓↓ Substantially weaker than status quo (2028 outcomes)		↓ Somewhat weaker than status quo (2028 outcomes)	
Financial stability criteria				Other criteria				
		Going concern loss absorbency	Crisis management	Proportionality	Competition	Simplicity/ achievability	Funding costs (green means lower)	International alignment
No LAC	Option 1	↓	↔	↑	↔	↑	↔	↑
LAC	Option 2	↓↓	↑	↔	↔	↓	↑↑	↑↑

The key elements covered in Table 8 are discussed in turn below. In summary, the key aspects of the assessment are:

- We consider Option 1 to have more proportionality than the status quo, due to the larger difference between Group 1 and 2 requirements. It is also likely relatively simpler, given the

removal of AT1 from the framework, and more aligned with international approaches given the move to more granular risk weights. However, the reduction in CET1 reduces the going concern loss absorbency, increasing financial stability risks.

- Option 2 has a larger reduction in the level of CET1 capital than Option 1 – this means a larger drop in going concern loss absorbency in the system. However, there may be more scope for crisis management responses in Option 2, than Option 1 or the status quo, through the use of bail-in-able LAC instruments. However, as discussed in Box D above, this depends on the design of such instruments. This LAC would add complexity but would also lead to greater alignment with international approaches (on top of the removal of AT1 and risk weight changes).

Q15 Do you have any feedback on our analysis of the proposed options against the criteria?

Going concern loss absorbency

Both options entail a reduction in the level of CET1 (going concern capital) relative to the fully implemented 2019 Capital Review decisions. As noted in Section 1.2, going concern capital is designed to absorb losses to reduce the probability of distress, and the smaller the buffer the greater the likelihood of a deposit taker failing.

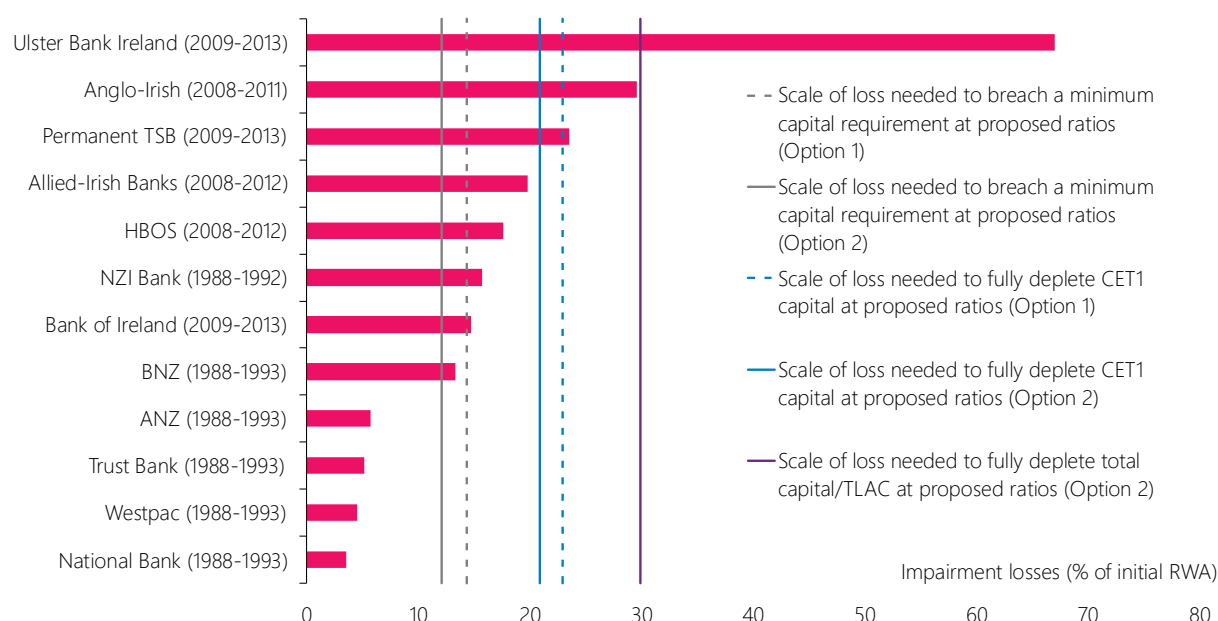
In the 2019 Capital Review Regulatory Impact Assessment, we estimated the scale of a loss event that would lead to a domestic systemically important bank (**D-SIB**) reaching the point of failure with the new capital requirements.⁵² We calculated the impairment losses that would be necessary for a Group 1 deposit taker to either breach its minimum capital requirements or exhaust all of its Tier 1 capital, and compared this to historic loss experiences in New Zealand and internationally. The results showed that the new requirements would be sufficient for a D-SIB to absorb the credit losses of most New Zealand banks in the late 1980s and early 1990s, but not to prevent failure if they were faced with the losses experienced by some Irish banks during the Global Financial Crisis (**GFC**).

Figure 16 presents updated results showing that the size of impairment losses which Options 1 and 2 protect against (prior to any LAC conversion) are not dramatically different to those that were achieved by the 2019 Capital Review decisions. That is, Group 1 deposit takers could lose around 12-14% of starting RWA (in credit losses over several years) before depleting their buffer and breaching minimum requirements. It would take a loss of around 21-23% of RWA before CET1 capital was fully depleted.

There would be a material increase in the size of the impairment loss that could be withstood under Option 2 if LAC was converted effectively. Successful LAC conversion would materially increase the probability that a New Zealand Group 1 deposit taker could survive the estimated median loss experience of the sampled Irish banks during the GFC (i.e., the loss experience of Permanent TSB in Figure 16 below).

⁵² See page 46 in Reserve Bank of New Zealand. (2019). *Capital Review: Regulatory Impact Assessment and Cost-Benefit Analysis 2019*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-cost-benefit-analysis.pdf>.

Figure 16: New Zealand capital levels compared to examples of previous large loss events



Source: Companies' financial statements, RBNZ estimates.

NZI Bank and BNZ incurred smaller, but still significant, losses in the late 1980s and early 1990s. Both banks required capital injections from shareholders and saw a significant loss of market share, leading to NZI Bank eventually exiting the market. Figure 16 shows that these losses would not fully deplete a D-SIBs' CET1 capital under either option. Option 1 would provide just enough CET1 capital for a D-SIB to absorb a BNZ-scale loss event and continue to meet their minimum capital requirements. Neither option would prevent a Group 1 deposit taker from breaching their minimum capital requirements if they experienced the losses of NZI Bank.

It is also worth noting that the loss experiences of New Zealand finance companies during the GFC are more comparable to Irish Banks in the GFC than New Zealand banks in the 1990s, in terms of impairment losses as a percentage of initial RWA. Although finance companies have operated under new prudential requirements since the GFC, the Group 3 minimum requirements we have imposed are not intended to make the failure of a Group 3 deposit taker impossible.

Crisis management

While having a sufficient amount of going concern capital is important to reduce the *probability* of distress, gone concern capital can enable an enhanced range of crisis management options if a deposit taker is likely to fail or has failed. As noted in the Terms of Reference, the balance of going and gone concern capital is a key question for this Review.

As discussed in Box B, our preferred crisis management approach for Group 1 deposit takers involves Australian and New Zealand authorities co-ordinating a SPE strategy.

Internal LAC (Option 2) has the potential to enhance the current SPE approach for Group 1 deposit takers by providing a legal mechanism to ensure the down-streaming of new Tier 1 capital in a group-level recovery situation. This would likely support trans-Tasman co-ordination in a recovery situation and, as discussed later in this Consultation Paper, may be a cheaper option for industry given the lower cost of issuing internal LAC instruments.

However, it would not remove all the risk and difficulty potentially involved in a trans-Tasman crisis. For example, there is a risk that the level of pre-positioned internal LAC in our framework would turn out to be insufficient to recapitalise the New Zealand deposit taker to acceptable levels, leaving us in the position of needing to negotiate additional capital down-streaming on top of LAC or considering alternative options.

There may also be uncertainty about how well LAC would work to stabilise and recapitalise a distressed deposit taker given the potential complexity of some LAC instruments, public signalling effect of writing down or converting LAC instruments, and difficulty in predicting the broader environment in which the writing down or conversion of LAC instruments might need to occur.

Importance of an adequate buffer

An adequate capital buffer is essential to the operation of the crisis management framework as it provides additional time to identify and respond to circumstances where a deposit taker's financial position is deteriorating. Option 1 provides for a larger prudential capital buffer than Option 2 (8% compared to 6%) and therefore increases the scope to take pre-emptive action to recover a deposit taker and reduces the risk of a deposit taker failing. However, while it has a lower buffer, Option 2 includes LAC - which provides an additional mechanism to stabilise a deposit taker (assuming that the total quantum of LAC is sufficient for this purpose).

We note that we are likely to revisit aspects of the current Capital Buffer Response Framework (**CBRF**) under either Options 1 or 2, given how they reduce the size of the PCB relative to what it would have been in 2028 (i.e., if the 2019 Capital Review decisions had been fully implemented). However, the scale of change will likely be less under Option 1 given the smaller reduction in the size of the PCB under that option. In any event, we would likely be considering the calibration of the CBRF as part of future work on a crisis preparedness standard.⁵³

Need for a credible fallback option

In both Options 1 and 2, it is important that we retain a credible fallback option for separating and resolving the New Zealand deposit taker (as discussed in Box B). In particular, this supports the importance of flexibility in crisis management, as highlighted by the 2023 bank failures overseas (discussed in Section 2.2), and our statutory obligation in the DTA to prepare resolution plans for all deposit takers. This will be addressed in our work to implement the crisis management framework over the next several years.

Group 2 and 3 deposit takers

Options 1 and 2 both represent a reduction in the size of the PCB for Group 2 (i.e., a 5% PCB compared to 7% in 2028 under the original 2019 Capital Review decisions). This is necessary to ensure proportionality across Group 1, 2, and 3. However, it does represent an increased risk from a crisis management perspective due to the smaller PCB increasing the likelihood of a Group 2 deposit taker failing.

Both Options 1 and 2 include the same PCB requirement as proposed in the DTA Capital Standard consultation in 2024 for Group 3 deposit takers. This would be a new requirement relative to the

⁵³ This is discussed further in Reserve Bank of New Zealand. (2024). *Crisis Management under the Deposit Takers Act 2023*. https://consultations.rbnz.govt.nz/dta-and-dcs/crisis-management-under-the-deposit-takers-act/user_uploads/crisis-management-issues-paper-august-2024.pdf

current requirements under the NBDT Act and as such acts to support the operation of an effective crisis management framework for those deposit takers.

Q16 Do you think it would be preferable from a crisis management perspective to maintain a higher Prudential Capital Buffer or have a lower Prudential Capital Buffer and Loss-Absorbing Capacity for Group 1?

Q17 If you consider that one option is preferable, what are the reasons why?

Proportionality

While the approach to Group 2 and 3 is the same in Options 1 and 2, the proportionality impacts do differ. As discussed above, Options 1 and 2 have distinctly different approaches to Group 1 deposit takers.

In Option 1, the difference between PCBs for Groups 1 and 2 (the D-SIB buffer) would increase from 2% under the status quo of 2019 Capital Review decisions to 3% of RWA, reflecting the lower risks to financial stability for Group 2 relative to Group 1. This is in line with the approach to proportionality set out in the Proportionality Framework that we published in 2024.⁵⁴ This option would result in a significant increase in proportionality for Group 2 compared with Group 1.

In Option 2, proportionality between Groups 1 and 2 is achieved in a different way. Option 2 sees a difference in the PCB of 1% between Groups 1 and 2, down from the status quo of 2%. However, Group 1 deposit takers in Option 2 would also be required to have 6% of LAC, held by their parent entities. Group 1 deposit takers would need to fund this LAC with instruments that we expect will be more expensive than other forms of debt funding. Group 2 deposit takers will not have to source this LAC and will instead be able to use debt (or deposits) to fund the rest of their activities. This will preserve a degree of proportionality for Group 2 deposit takers.

From a proportionality perspective, the differences between settings for Groups 2 and 3 would be smaller than included in the May 2024 DTA Capital Standard proposals. Most Group 3 deposit takers would have a 1% lower capital requirement than Group 2. For the smallest Group 3 deposit takers with no credit rating, there would be no difference between their policy settings and Group 2 deposit takers.

The changes in risk weights in Chapter 5 also act to increase proportionality under both options. Group 1 deposit takers' overall RWAs reduce by around 4.9% (a fall of around \$2.9 billion in capital required) and Group 2 deposit takers' RWAs reduce by around 10.9% (a fall of around \$1 billion in capital required) under the proposals.

Q18 Do you have any feedback on the degree of proportionality across the proposed options and capital stacks?

⁵⁴ Reserve Bank of New Zealand. (2024). *Proportionality Framework*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/dta-and-dcs/the-proportionality-framework-under-the-dta.pdf>

Competition

New Zealand's deposit-taking sector is highly concentrated. The four largest Australian-owned banks hold approximately 85% of total bank lending and deposits. Large banks may also sometimes benefit from being perceived as "too big to fail". In contrast, smaller New Zealand-owned banks and non-bank deposit takers (**NBDTs**) generally hold a minor market share. Market dynamics are largely shaped by scale, technology access and brand strength (see Box C for details).

Capital settings may influence competition within the deposit-taking sector. However, the impact of these possible capital changes on competition is much less significant than other competitive factors, such as market structure.

As set out above, our approach to proportionality (based on our Proportionality Framework) means that smaller deposit takers will be subject to proportionately lower capital requirements than relatively large deposit takers, which can support competition by easing entry and reducing unnecessary compliance burden.

Risk-based capital requirements are calibrated to different asset classes. We aim for lending-neutral outcomes to avoid favouring particular sectors. Larger banks use internal models (**IRB**), while smaller institutions typically use the standardised approach. We are proposing more granular risk weights for the standardised approach to lower average risk weights by measuring risks more accurately. As a result, Group 2 and 3 deposit takers will benefit from this granular risk weighting under either Option 1 or 2. The impact will be the largest for Group 3 deposit takers that have significant levels of residential mortgage lending (**RML**) exposures, where the changes in risk weights are the largest. Those with significant commercial property lending or personal lending may also benefit. Group 1 deposit takers can also benefit from the proposed changes in standardised risk weights through the IRB output floor⁵⁵. However, the impact is likely to be relatively limited.

As set out in the Summary of Submissions and Policy Decisions for the Capital Standard, we have decided to reduce the minimum capital requirement from \$30 million to be a registered bank in New Zealand to \$5 million to operate as a Group 3 deposit taker under the DTA. This may support competition as the current requirements of \$30 million can add to the hurdles for a NBDT to become a registered bank. In the absence of that barrier, and with lower, standardised risk weights proposed to also apply to Group 3, these deposit takers may be able to expand and provide more competition. However, as these are small deposit takers, the ultimate impact on system-wide competition is likely to be small in practice.

Under Option 2, Group 1 deposit takers' capital funding would be restricted to CET1 and Tier 2/LAC capital instruments. As all Group 1 banks have Australian parent banks, in practical terms this would mean all CET1 and Tier 2/LAC would have to be issued to their parent bank. The change in balance of equity and debt instruments under Option 2 may result in marginally lower funding costs than Option 1. However, it increases the total amount of capital funding required and also the dependence of the New Zealand subsidiaries on their parents for their capital funding.

⁵⁵ We restrict the risk weights calculation outcome in the IRB approach to be no lower than 85% of the outcome for the same exposures in the standardised approach. Changes to the standardised approach would therefore benefit the Group 1 deposit takers (assuming no change to the IRB output floor).

We also separately plan to consult on introduction of a new Crisis Preparedness Standard (section 89 of the DTA), which would help deposit takers to manage and respond to distress in a timely and orderly manner. This standard may include exit planning requirements that would be able to support deposit takers' efficient entry and exit/wind-down. These kinds of requirements may help prevent an abrupt cessation of service provision and open space for new entrants and for more efficient deposit takers to grow. This ultimately can also contribute to a competitive and dynamic financial system.

Q19 Do you have any feedback on the implications for competition from our proposed options?

Simplicity/achievability

The removal of AT1 from the framework means that Option 1 would be simpler than the status quo (2028 outcomes). This is discussed in further detail in Section 4.2.

Option 2 would introduce more complexity through the introduction of LAC. As highlighted by the 2023 overseas bank failures overseas (discussed in Section 2.2), bail-in is highly complex. Option 2 would also likely be more complex to administer, depending on the design of LAC instruments (due to the need to assess the effectiveness of proposed bail-in terms in Tier 2 and LAC instruments).

However, as discussed in Box D, at least some of the potential concerns about contractual bail-in features may not apply here, given the option involves relying on internally issued Tier 2 and LAC instruments. In particular, the use of internally issued instruments removes difficulties that can be associated with bailing-in external investors. We anticipate that the relevant contractual terms would be largely standardised in Tier 2 and LAC instruments under this option. Depending on the outcome of this Review, we would consult further on design issues relating to these instruments.

Impacts on lending rates

Deposit takers incur costs for holding capital. These costs on deposit takers can lead to greater costs of bank lending, lower returns for depositors and lower economy activity – though capital requirements also help protect against the economic costs of financial instability.

To estimate these costs, we have updated the model used in the 2019 Capital Review, which estimates a weighted average funding cost (**WAFC**) for the deposit-taking sector. Details on the model can be found in the 2019 CBA⁵⁶ and a description of the updated model and results are provided in Annex E. A summary of the impact on lending rates is provided in Table 9.

The model seeks to calculate an average financing cost for the deposit-taking sector; therefore, the model is highly sensitive to assumptions regarding Group 1 and large Group 2 deposit takers' capital structures. Compared to our estimate of current funding costs as of March 2025, we expect Option 2 to have the largest decrease in lending rates compared to the status quo (2019 Capital Review decisions). This is primarily due to replacing higher cost equity capital with LAC.

56 Reserve Bank of New Zealand. (2019). *Capital Review: Regulatory Impact Assessment and Cost-Benefit Analysis 2019*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-cost-benefit-analysis.pdf>

Table 9: Summary of estimated impact on lending rates

	Status quo: 2019 policy decisions	Option 1: Non-LAC	Option 2: LAC
Tier 1 capital (\$bn)	67	55	49
Total Loss-Absorbing Capacity (TLAC) (\$bn)	75	66	79
Impact on lending rates (bps), as compared to current (March 2025)	+7.1	-0.9	-6.7

Table 9 shows the average expected change in lending rates. However, this change is likely to be spread unevenly across different lending categories. Higher risk lending (lending that requires more capital) is expected to experience a greater fall in lending rates than lower risk lending.

For example, we estimate that the lower lending rates from Option 1 and 2 would benefit agricultural lending more than the relatively lower risk residential mortgage lending (Box E, Annex E). This also takes into account the lower and more granular risk weights proposed in Section 5.2.

Options 1 and 2 are expected to:

- reduce interest rates on agricultural lending by approximately 20 basis points as compared to the 2019 policy settings and approximately 7 basis points from current levels; and
- reduce interest rates on mortgage lending by approximately 5 basis points as compared to the 2019 policy settings and be similar to current levels.

Model changes from 2019

We have made several changes to the model to improve comparability between the LAC and non-LAC option. However, due to the novelty of internal LAC in New Zealand this consultation is designed to test our assumptions.

The key decisions and changes from the 2019 model include:

- As in 2019, we assume expected returns for capital owners are sensitive to the amount of capital. The same change in expected return assumptions in the 2019 model are used for changes in capital. That is, the same assumptions about the “Modigliani-Miller (**MM**) effect”⁵⁷ are used. That is, for each percentage point increase in assets funded by equity capital we assume expected cost of equity capital to decrease by 9.5 basis points, and Tier 2 debt capital to decrease by 16.4 basis points. This is equivalent to an MM effect of around one third (see Annex E for details). For example, if a deposit takers’ equity capital as a percent of assets decreases from 15% to 12% we model the required rate of return on that equity capital to increase by 0.28 percentage points.

⁵⁷ Researchers at the Bank of England found empirical evidence of the existence of the Modigliani-Miller theorem: finding that more equity in a bank’s balance sheet reduces the risk premium associated with that bank’s funding, see Gimber, A. R., & Rajan, A. (2019). Bank funding costs and capital structure. *Bank of England Staff Working Paper*, 805. <https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2019/bank-funding-costs-and-capital-structure.pdf>

- We assume deposit takers will substitute expensive equity financing with debt financing to the point they meet their capital requirements with a 1% minimum management buffer. Subject to meeting each of their capital requirements, the cheapest form of available financing is assumed to be used.
- We assume all changes in weighted-average funding costs are passed on to borrowers. In addition, for simplicity we assume that when calculating the impact on economic activity that all cost changes are passed onto borrowers: this was also assumed in the 2019 Capital Review. In reality, changes to deposit takers' funding costs will be spread between depositors and borrowers.

There are also a range of technical changes and assumptions, which include:⁵⁸

- Internal LAC and Tier 2 debt has been priced identically using market data. LAC design settings (and the implications for Tier 2) have not been finalised, but the CBA assumes that for Group 1 deposit takers that both LAC and Tier 2 would be issued internally to the overseas parent entity. The overseas parent would then issue a similar instrument to the market. With this type of 'back-to-back' issuance in mind, internal LAC has been priced based off recent issuance of Tier 2 instruments by Australian banks. At this stage we assume this method is a fair and reasonable estimation of LAC and Tier 2 costs. However, we seek feedback on whether these are reasonable assumptions. AT1 has been priced by recording the cost of historical market issuances of these instruments.
- We have also explored the debate about the impact that capital levels (or 'risk' in general) have on required equity returns. In response to this we investigated calculating deposit takers' equity costs using a Capital Asset Pricing Model. This approach is akin to assuming full MM effects. First, we used a beta of 1,⁵⁹ and alternatively we also adjusted the observed equity beta of parent banks based on differences in debt/equity ratios (the Hamada equation). This exercise clarified plausible ranges for the cost of equity (between 8% and 12%) for Group 1 deposit takers. For consistency with the 2019 results we propose using the same (one-third MM) effects described above in our central analysis.
- We also considered adjustments to the MM effects. Table 26 in Annex E provides scenarios where the increase in return expected by investors from a change in capital is halved and doubled, respectively. These changes provide a gauge of the range of possible lending rate impacts.

International alignment

As discussed in Section 2.3, we commissioned an independent report to assess how New Zealand's capital requirements compare with key comparator countries (the **Oliver Wyman report**). We have adjusted the five largest New Zealand banks' capital ratios to reflect Options 1 and 2, using the same methodology as in the Oliver Wyman report. This allows us to compare the options against current capital settings (as at July 2025), capital ratios in 2028 if the 2019 Capital Review decisions were fully implemented, and current capital ratios in selected peer countries. In this

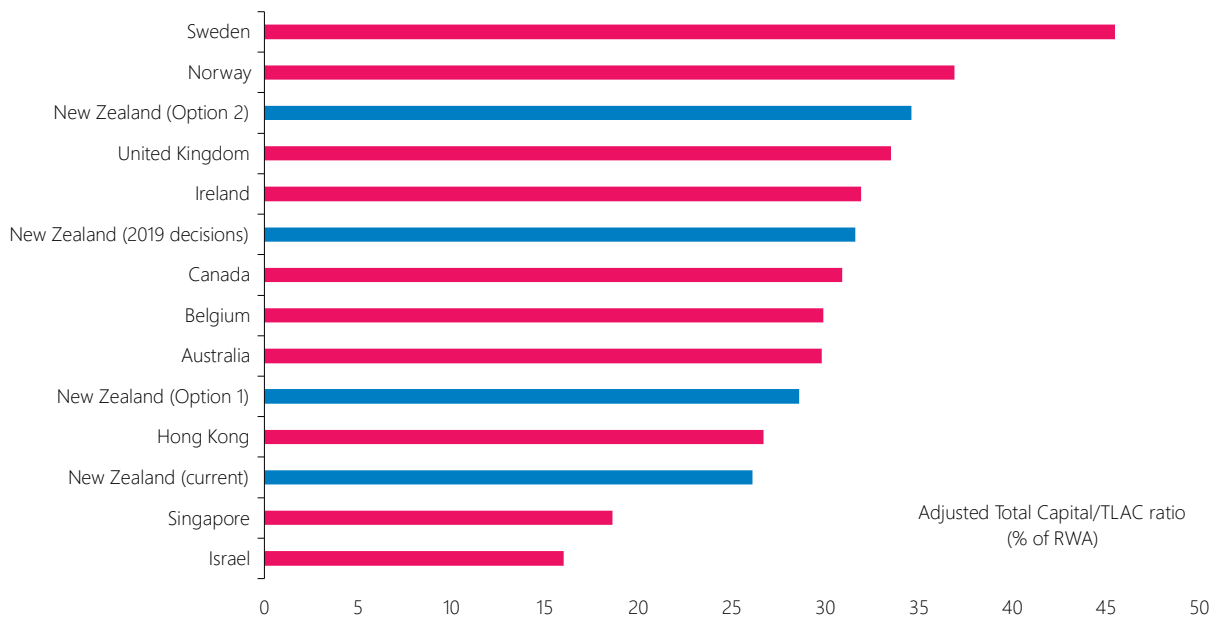
⁵⁸ Further details are provided in Annex E.

⁵⁹ 'Beta' measures an entity's market risk. A beta of 1 means the entity is roughly as risky as the market. Similarly an 'equity beta' or levered beta, takes into account the entity's capital structure when measuring its sensitivity to market risk.

section, we show estimates of how Option 1 and 2 would change how New Zealand would sit internationally in terms of the adjusted capital ratios discussed in Section 2.3.

Figure 17 shows that both options would significantly impact the major New Zealand banks' overall loss absorbency. Option 1 would reduce their adjusted total capital ratio relative to the 2019 Capital Review decisions, placing them below major Australian banks. Option 2 would increase the five largest New Zealand banks' TLAC ratio to around the levels of some European countries. The estimates for New Zealand include the effect of the standardised risk weight changes proposed in Chapter 5, which reduce the adjusted CET1 ratio by around 70 basis points.

Figure 17: Adjusted total capital/TLAC ratios with Options 1 and 2 and in comparator countries



Source: Oliver Wyman report *Comparing New Zealand Bank Capital Ratios to International Peers*, RBNZ estimates.

Either option would result in a slight decrease in the major New Zealand banks' adjusted CET1 ratio compared to the 2019 Capital Review decisions. This is because of the reduction in risk weights proposed in Chapter 5 and, for Option 2, the more significant reduction in the PCB. However, the major banks' adjusted CET1 ratio would still be the highest in the set of comparator countries with either option. The five banks would also continue to be near the 75th percentile of Basel Group 2 banks' unadjusted CET1 ratios.

There are limitations to these international comparisons. Adjusted capital ratios in peer countries are based on current reported ratios, so they do not consider changes that are yet to be implemented globally. Basel rules allow flexibility (that cannot be captured in the adjustments), and this means banks in some countries have more capital per dollar of lending than the largest New Zealand banks, despite having lower adjusted capital ratios (as shown by capital coverage ratios in Israel and Ireland in Figures 14 and 15 in Section 2.3).

Both options would entail greater alignment with international approaches. For both options this comes from the removal of our New Zealand-specific AT1 instruments and the introduction of more granular risk weights. Option 2 would also make use of LAC, which is common in a number of other countries, as discussed in Section 2.3.

Q20 Do you have any feedback on our analysis of the options against the assessment criteria?

3.6 Summary of cost benefit analysis

We have sought to quantify the impacts of the two proposed options, where possible. As in 2019, the models used in estimating the costs and benefits of each option are highly stylised and are dependent on a relatively small number of inputs. Nevertheless, similar models are widely used globally,⁶⁰ and provide a helpful piece of the puzzle when evaluating each option. The CBA should be read alongside (rather than instead of) the qualitative analysis provided throughout this Consultation Paper. The CBA covers areas that we were confident could be quantified in a robust framework. Other, harder to quantify factors, such as impacts on competition, are not quantified in the CBA. This does not mean these are not important factors, just that we did not identify any robust way to include these in the modelling framework.

We have used the same underlying approach to the CBA as in the 2019 Capital Review, which attempts to measure the costs and benefits of capital through its impacts on expected gross domestic product (**GDP**).⁶¹ We have made some adjustments, including:

- updating input data to reflect the most recent deposit taker balance sheets;
- using updated market data to estimate the costs of capital; and
- estimating the costs and benefits of LAC and incorporating this aspect into the modelling framework.

The CBA can be split into two broad impacts - an economic output impact and a direct impact. The economic output impact estimates the impacts of lower capital on economic output through two somewhat offsetting impacts:

- A lift in long term output in the economy from lower lending rates (lending rate impact)
- A fall in long term output from the increased risk of a banking crisis, where all capital in the system is run down during a shock (cost of crisis impact).

These two impacts of lower capital work in opposite directions, and a key role of the CBA is to compare the effects of these two impacts. Analysis of lending rates and costs of crises is internationally orthodox, and we rely on credible international studies for our assumptions.⁶²

The direct impact is the cost to New Zealand of the transfer of funds from New Zealand borrowers, through the deposit taker, and ultimately to their overseas owners. Returns to equity

60 Banking Committee on Banking Supervision. (2021). *Assessing the impact of Basel III: Evidence from macroeconomic models: literature review and simulations*. <https://www.bis.org/bcbs/publ/wp38.pdf>

61 For more details on the approach used in 2019 and as the basis for the analysis presented here, see Reserve Bank of New Zealand. (2019). *Capital Review: Regulatory Impact Assessment and Cost-Benefit Analysis 2019*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-cost-benefit-analysis.pdf>.

62 Basel Committee on Banking Supervision. (2010). *An assessment of the long-term economic impact of stronger capital and liquidity requirements*. <https://www.bis.org/publ/bcbs173.pdf>

holders are taxable therefore any reductions in payments would see a lower amount of tax collected on payments to overseas owners.

The result of our CBA is shown in Annex E. We compare the options presented in this paper with the status quo of the policy settings decided in 2019 being fully in force in 2028, and conduct sensitivity analysis to some key assumptions. While there is a high degree of uncertainty, the analysis suggests:

- **Lower lending costs for New Zealanders:** Both options are expected to lower lending rates as compared to the 2019 Capital Review decisions. We estimate a reduction of 6-10 basis points for Option 1 and 11-17 basis points for Option 2. The lending rate impact for Option 2 is sensitive to the pricing of internal LAC, which comes with additional uncertainty.
- **More frequent bank failures:** The cost of bank failures on New Zealand is expected to increase under both options. Option 1 is estimated to increase the cost of bank failures by 0.19-0.24% of annual GDP. The increase in cost for Option 2 is estimated to be lower at 0.01-0.09% – but there is a higher degree of uncertainty in predicting the costs associated with triggering LAC.
- **Marginally less transfers to overseas owners:** The lower level of common equity in both Option 1 and 2 means deposit takers are required to generate and return lower nominal profits to their (overseas) owners. In our methodology this is a benefit to the New Zealand economy. The benefit is partially offset by the reduced tax revenues on that profit.
- **Small net costs or benefits compared to the status quo:** In comparison to the 2019 Capital Review decisions Option 1 is expected to have a net cost on the expected level of GDP of 0.04-0.13%, while Option 2 is expected to have a net benefit on the expected level of GDP of 0.14-0.26%.

To introduce a different counterfactual, we would expect both options to result in a net benefit to New Zealand relative to the capital requirements in place before the 2019 Capital Review.

- | | |
|------------|--|
| Q21 | Do you have any feedback on our approach to the cost benefit analysis? |
| Q22 | Do you have any feedback about the results of the cost benefit analysis? |
| Q23 | Do you have any additional evidence that should be considered in the cost benefit analysis? |
| Q24 | Do you have any comments about the way that Loss-Absorbing Capacity has been incorporated into the approach? |

4 Additional Tier 1

This chapter sets out our proposal to remove Additional Tier 1 (**AT1**) as one of the eligible forms of regulatory capital in New Zealand. It covers:

- some background on AT1 and some challenges with it (Section 4.1); and
- some analysis of our proposal to remove it from the capital stack (Section 4.2).

4.1 Background

As discussed in Section 1.2, our current framework defines three forms of regulatory capital. AT1 is a form of regulatory capital that sits between Common Equity Tier 1 (**CET1**) capital and Tier 2 capital – the design of these instruments mean they absorb losses after CET1, but before Tier 2. AT1 was originally implemented in New Zealand as part of reforms to the international banking regulatory framework in response to the Global Financial Crisis.

AT1 was developed as a form of capital to provide loss-absorption on a going concern basis – that is, to support the deposit taker and keep it in business. In the Basel international framework, AT1 was intended to do this in two ways:

- By cancelling distributions to allow a deposit taker to preserve its capital at any point in time (typically in times of stress).
- By converting the instrument into ordinary shares (or being written off as the case may be) at a trigger point and providing additional CET1.

AT1 is more effective at absorbing losses than Tier 2 capital, but less effective than CET1. CET1 automatically absorbs losses as they occur, with Tier 2 only absorbing loss at the point of insolvency. AT1 is, therefore, intended to occupy a middle ground, functioning both in early crisis intervention (absorbing losses through the cancellation of distributions) and in resolution.

AT1 in New Zealand – what did we do?

Following the 2019 Capital Review, the Reserve Bank's definition of AT1 capital diverged from the internationally standard Basel requirements. We decided to no longer allow instruments with contingent convertibility clauses (i.e., clauses that provided for the conversion/write-off of instruments including AT1 capital on the happening of a specified event) to qualify as regulatory capital. As part of the 2019 changes, AT1 was also required to be treated as an equity instrument both from a legal and accounting perspective.

In 2019, we decided to increase the proportion of Tier 1 capital that could be met by AT1 capital from 1.5% to 2.5% of risk-weighted assets. This was to provide additional flexibility for banks to meet the Tier 1 capital requirements which were increased as part of the 2019 work.

Together with the other changes made during the 2019 Capital Review, these changes were intended to:

- Remove uncertainty about whether new shares would be issued in the New Zealand subsidiary or the Australian parent when the contingent convertibility feature of AT1 instruments was triggered.

- Remove uncertainty about the loss-absorbing value (in practice) of debt forms of capital upon conversion or write-off.
- Enhance the ability for capital to absorb losses before they are imposed on creditors and depositors.
- Reduce the complexity of the capital regime, making the capital framework simpler to administer and comply with.
- Ensure the capital framework was suitable for deposit takers with mutual ownership structures.
- Increase transparency to enable effective market discipline.

Since 2021, banks have been transitioning to the new requirements. This has involved a mix of replacing pre-2019 AT1 instruments and utilising the increased AT1 allocation.

Challenges for New Zealand deposit takers issuing AT1 – what is the problem?

We have continued to discuss the nature of AT1 capital with deposit takers as they transition to the new requirements. We have also received feedback on this topic in response to the consultation on the Capital Standard (as part of the Deposit Takers Core Standards consultation in 2024). This has been summarised in the Summary of Submissions and Policy Decisions for the Capital Standard released alongside this Consultation Paper.⁶³

What we have heard is that, although we sought to improve the effectiveness of AT1 in New Zealand during the 2019 Capital Review, there are certain features which are making it difficult for deposit takers to issue it efficiently.

Table 10: Key feedback received about AT1

Feature	Comment
Treatment as equity	Imputation credits form part of the distributions to investors in relation to equity instruments (i.e., recognising the tax already paid by the deposit taker). These have limited or no value to investors without New Zealand tax liabilities (such as foreign investors or domestic charities), which means effective returns are lower than for New Zealand taxpaying investors. We have been told by deposit takers that the impact of the imputed nature of distributions is significant, as it effectively restricts the potential investor universe to New Zealand taxpayers. However, industry has also told us that the domestic market lacks the capacity to absorb the scale of AT1 that could otherwise be issued to help deposit takers meet Tier 1 capital requirements. Other consequences include: • Distributions are not tax deductible unlike interest expense. • Hedge accounting cannot be used to deal with currency fluctuations which can make CET1 levels volatile if AT1 is issued in a foreign currency.

⁶³ Reserve Bank of New Zealand. (2025). *Deposit Takers Core Standards: Summary of Submissions and Policy Decisions for the Capital Standard*. https://consultations.rbnz.govt.nz/dta-and-dcs/deposit-takers-core-standards/user_uploads/summary-of-submissions-policy-decisions-capital-standard.pdf

Feature	Comment
	Companies Act requirements impact the ease of banks to carry out market making activity in their own equity securities (as compared to debt securities).
Absence of conversion or write-off features	AT1 in New Zealand does not include all the features set out in the Basel requirements for AT1 and so 'looks different' to AT1 used in many other countries, particularly Australia. Early feedback from deposit takers on this requirement (received in response to the 2019 Capital Review consultations as well as in subsequent discussions) suggested it may lead to difficulties in selling AT1 to global investors unfamiliar with New Zealand banks. Recent feedback has not focused on this feature.

As a way of addressing these challenges, some deposit takers are exploring novel ways to issue AT1 offshore.⁶⁴ The creation of complex structures to issue to foreign investors may be within the abilities of the larger deposit takers, but possibly not smaller deposit takers. This suggests that retaining AT1 favours larger deposit takers.

Current observations

Despite the challenges discussed above, we have seen that AT1 has been successfully issued at a lower margin than we expected when the 2019 Capital Review decisions were made.⁶⁵

However, we understand that all AT1 issued post-2019 has either been issued to a parent (or otherwise within the banking group) or quoted on the NZX Debt Market. None has been issued in foreign currency or directly to overseas third-party investors.

We are also aware that there is approximately \$5.8 billion of AT1 on issue, of which just under \$1.5 billion is transitional AT1 (i.e., issued pre-2019 and needing to be replaced). Should all deposit takers seek to maximise their AT1 allocation to meet Tier 1 capital requirements, a further \$5.5 billion would need to be issued by 2028.⁶⁶

Growing international concerns

International experience is increasingly showing that AT1 does not provide the loss-absorption nor have the stabilising effect it was initially designed to achieve.

Concerns revolve around the signalling risk of withholding distributions to investors or not redeeming instruments when expected.⁶⁷ Equally, there are concerns about the effectiveness of

⁶⁴ For example, see KangaNews. (2024). *ANZ's Australian AT1 access could be a game changer*.

<https://www.kanganews.com/news/20153-anz-s-australian-at1-access-could-be-a-game-changer>.

⁶⁵ As part of the cost benefit analysis of the 2019 Capital Review, we estimated that investors would require a margin of approximately 4% above current swap rates to purchase new-style AT1 instruments. We committed to monitoring the outcome of the 2019 Capital Review, and published the first biennial assessment of the implementation and impact of the changes in early 2024. One of the trends we identified in the first review was that average AT1 margins were 2.93% which was lower than the 4% we had originally estimated. We have also observed AT1 issuances since that publication which have been priced with a margin below 4%. See Downing, R., Martel, J., & Tanuvasa, W. (2023). *Biennial Assessment 2023 Monitoring Capital Review Implementation*. *Reserve Bank of New Zealand Bulletin*, 87(3). <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/bulletins/2024/rbb-2024-87-03.pdf>.

⁶⁶ Based on data taken from the RBNZ dashboard for Q1 2025 and latest disclosure statements. To view the dashboard, see Reserve Bank of New Zealand. (2025, March 31). *Bank Financial Strength Dashboard*. <https://bankdashboard.rbnz.govt.nz/summary>.

⁶⁷ Credit Suisse did not defer a coupon, fearing market reaction. In addition, it also continued in its practice of redeeming instruments at the earliest opportunity to avoid the negative signalling. As such, not only did its AT1 not have the intended stabilising effect,

conversion in a stress event.⁶⁸ The former risk is relevant in New Zealand, but the latter is not, given the design of AT1.

In 2024, following an extensive consultation process, the Australian Prudential Regulatory Authority (APRA) announced it was phasing out AT1 as eligible bank capital in Australia.⁶⁹ This was because of concerns that AT1 would not be effective to stabilise a stressed bank and restore market confidence.⁷⁰ Submissions to APRA's consultation broadly supported APRA's view that AT1 had not been shown to act effectively in a going concern scenario and did not offer advantages to Tier 2 in resolution.

Features such as the investor base also influence how regulators consider the various risks in their jurisdiction. Some jurisdictions explicitly prohibit retail investors from being able to buy AT1 instruments.⁷¹ In contrast, structural features in Australia have led to heavy retail involvement in AT1 which was one of the features taken into account in APRA's decision to remove AT1.⁷² New Zealand does not prevent retail investors from investing in AT1, but there are requirements that must be met around selling and disclosure documentation.⁷³

Whilst APRA may have been the first regulator to remove AT1 from its capital stack, other international regulators have also raised concerns.⁷⁴

4.2 Proposal to remove AT1 capital

In Table 11 below, we consider whether to remove or retain AT1 capital in the capital stack based on the assessment criteria discussed in Section 1.3.

conversely it increased the financial pressure on the bank. See Federal Department of Finance. (2024). *Federal Council report on banking stability*. <https://backend.efd.admin.ch/fileservice/sdweb-docs-prod-efdadminch-files/files/2024/05/15/caea5dcd-9d25-4f83-b7c2-67473b7f98ab.pdf>.

68 For example, in the case of Banco Popular, the trigger of 7% of CET1 (which was above the regulatory minimum) was not meaningful and the bank failed anyway.

69 Australian Prudential Regulation Authority. (2024). *APRA to phase out AT1 as eligible bank capital*. <https://www.apra.gov.au/news-and-publications/apra-to-phase-out-at1-as-eligible-bank-capital>

70 Australian prudential Regulation Authority. (2024). *A more effective capital framework for a crisis*. <https://www.apra.gov.au/a-more-effective-capital-framework-for-a-crisis>

71 The European Union and United Kingdom generally restrict retail investors from investing in AT1 instruments. High levels of retail participation can add complexity to utilising AT1 to support the resolution of banks in crisis.

72 Australian prudential Regulation Authority. (2024). *A more effective capital framework for a crisis*. <https://www.apra.gov.au/a-more-effective-capital-framework-for-a-crisis>

73 More information is available on the Financial Market Authority's website. See, for example, Financial Markets Authority. (2021). *Offer disclosure for equity and debt offers*. <https://www.fma.govt.nz/business/services/equity-or-debt-issuers/>.

74 For example:

- The Dutch government published a looking at particular policy options for AT1 capital including abolition or simplification, but noted that it could not implement changes by itself as it would require international and European Union co-ordination. See Ministry of Finance. (2024). *Policy directions for a resilient banking sector*. <https://www.government.nl/documents/reports/2024/03/19/policy-directions-for-a-resilient-banking-sector>.
- The Basel Committee on Banking Supervision published a report on the 2023 banking turmoil, noting there is potential for further international consideration and indicating that a key measure is to look at AT1 and to strengthen risk-bearing functions. See Basel Committee on Banking Supervision. (2023). *Report on the 2023 banking turmoil*. <https://www.bis.org/bcbbs/publ/d555.pdf>.
- The Swiss regulator's report into Credit Suisse's failure noted that regulatory requirements for AT1 capital urgently needed to be reviewed at an international level. See Federal Department of Finance. (2024). *Federal Council report on banking stability*. <https://backend.efd.admin.ch/fileservice/sdweb-docs-prod-efdadminch-files/files/2024/05/15/caea5dcd-9d25-4f83-b7c2-67473b7f98ab.pdf>.

Table 11: Considering AT1 capital against the assessment criteria

Criterion	Comment
Going concern loss absorbency	Signalling risk is the risk that crystallises when a deposit taker changes its behaviour compared to what it has done in the past and in the absence of any external driver.⁷⁵ This can negatively impact loss absorbency on a going concern basis. For example, if a deposit taker stops paying distributions on AT1 instruments or decides not to redeem an AT1 instrument at the first opportunity when it has always done so in the past, this may send negative signals to the market about the stability of the deposit taker. The impact of this signal may be more detrimental to the safety and soundness of the individual deposit taker than the cost of the distribution or redemption suggesting AT1 provides minimal financial stability over Tier 2 capital. Removing AT1 removes this risk as it relates to these instruments.
Proportionality	Deposit takers that are part of larger corporate groups (primarily, but not exclusively, Group 1 deposit takers) can utilise their parents or other complex structures to issue AT1 in ways other deposit takers cannot. This helps those deposit takers overcome domestic market capacity constraints. Removing AT1 reduces any advantage or disadvantage based on size or structure of the deposit taker.
Competition	Deposit takers that cannot issue AT1 have to meet Tier 1 requirements with more expensive CET1 which may impact their ability to grow and to compete. Whilst removing AT1 does not directly impact this ability, it removes an option that is perceived as providing an advantage to others.
Crisis management	Removing AT1 may simplify some issues in relation to the development of our crisis management framework, including how to position our capital stack to enable co-ordination with APRA in a 'single point of entry' resolution scenario. For example, it would remove the need to consider what write down or conversion means in practice for current AT1 instruments (which are in the form of preference shares rather than debt) if we were to introduce bail-in into our crisis management framework.⁷⁶ However, AT1 provides a form of going-concern loss absorbency via the ability to cancel distributions and conserve capital in times of stress. As a form of perpetual capital, a deposit taker is not obliged to repay AT1 owners, unlike debt holders. Unless wholly replaced with CET1, the removal of AT1 will reduce these forms of loss absorbency across the financial system. Nevertheless, New Zealand has no experience of using AT1 to absorb losses in this way and so the ability to do so - and the impact of doing so - is untested.

⁷⁵ For example, during the COVID-19 pandemic, banks agreed with the RBNZ to suspend payments of dividends on ordinary shares (i.e., CET1 capital) and to not seek to redeem any AT1 or Tier 2 instruments on the dates of first call option, or before dates of final redemption date, or maturity date as applicable. However, these were restrictions applied to all locally incorporated banks for systemic stability purposes, rather than being designed to support an individual bank in stress. See Reserve Bank of New Zealand. (2020). *Explanatory note regarding dividend restrictions*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/news/2020/cor-changes-explanatory-notes.pdf?revision=501a1b2d-f805-42d5-b90d-fd560af502bd>.

⁷⁶ For further discussion of crisis management under the DTA, see Reserve Bank of New Zealand. (2024). *Crisis Management under the Deposit Takers Act 2023*. https://consultations.rbnz.govt.nz/dta-and-dcs/crisis-management-under-the-deposit-takers-act/user_uploads/crisis-management-issues-paper-august-2024.pdf.

Criterion	Comment
Funding costs	As a form of capital that sits between CET1 capital and Tier 2 capital, AT1 is typically cheaper than CET1 but more expensive than Tier 2. AT1 also provides a buffer against loss for holders of Tier 2 capital which may help keep Tier 2 margins lower. The way in which removing AT1 capital translates through to any impact on lending rates or funding costs more generally will depend on the option chosen to address the removal of AT1 (see further detail in Chapter 3).
Simplicity/achievability	The existence of AT1 capital instruments provides flexibility to deposit takers in how they can meet their capital requirements. Removing AT1 will simplify the regulatory stack. However, it will also reduce current flexibility. Appropriate transitional arrangements can be developed but, inevitably, will lead to some disruption for deposit takers.
International alignment	We discussed international concerns in Section 4.1. Removing AT1 as a regulatory capital option in New Zealand would align with APRA's approach.

The removal of complexity was an outcome we sought to achieve with the redesign of AT1 in 2019. We do not think there are possible changes to the design of AT1 that would enable deposit takers to issue it more efficiently, increase market capacity and still provide the desired regulatory outcome without also re-introducing complexity.

Furthermore, we have concerns about whether AT1 meets the other regulatory objectives it was designed to achieve. For example, even if it is used as intended, there are concerns that AT1 will have the effect of exacerbating rather than stabilising a stress situation.

For these reasons, we are proposing to remove AT1 as a form of eligible regulatory capital in New Zealand. We think this change is consistent with the main purpose of the DTA.

We are keen to develop transitional arrangements that minimise disruption as much as possible to both holders and issuers of AT1 instruments. Our broad expectation is that we would recognise current AT1 instruments as Tier 2 capital from the point the new requirements come into force. However, an alternative option might be to continue to allow current AT1 instruments to be recognised as Tier 1 capital, but subject to a derecognition schedule. We are interested in views from deposit takers on which is the better approach or whether there are other options we could consider.

As covered in Section 3.3, the removal of AT1 may create some challenges for Group 3 deposit takers as they transition to the new framework, particularly for those that currently have preference shares that make up part of their capital. We are interested in feedback from deposit takers about how to treat these in the future.

- Q25** Do you agree with the proposal to remove Additional Tier 1 capital as a form of regulatory capital?
- Q26** Are there any other factors that you think we should take into account in making this decision?

- Q27** Do you have any views on the most appropriate transitional arrangements, including how Additional Tier 1 capital instruments should be recognised after any possible removal?
- Q28** Are there any additional factors that should be taken into account for Group 3 deposit takers?

5 Standardised risk weights

This chapter sets out proposals for five key changes to standardised risk weights, which will increase granularity and aim to better align risk weights with the actual risk of the lending. The proposed changes are in:

- residential mortgage lending;
- corporate lending;
- agriculture lending;
- lending to community housing providers/housing co-operatives; and
- lending secured by whenua Māori.

The evidence we have reviewed supports a realignment of standardised risk weights in a number of areas. We intend to seek further evidence through this consultation to fill any existing gaps in our analysis that may be present due to data limitations.

The proposed changes have been driven by the main purpose of the Deposit Takers Act 2023 (DTA) “to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system”.⁷⁷ Our assessment is that a central part of supporting financial stability is ensuring that capital requirements, and thus risk weights, are closely aligned with actual risk. We have also considered the principles of the DTA⁷⁸ in formulating the changes proposed (see Annex C for more detail).

This chapter covers:

- some background on risk weights and the problem definition (Section 5.1);
- the proposed changes to standardised risk weights for residential mortgage, corporate and agricultural lending, including our analysis behind the proposed changes, and estimates the impacts these changes could have on New Zealand deposit takers (Section 5.2); and
- the proposed standardised risk weight approach for lending to community housing providers and housing co-operatives, and for lending secured by whenua Māori (Section 5.3).

Details, such as definitions, will be consulted on as part of the Capital Standard Exposure Draft in 2026.

5.1 Background

Capital requirements express the amount of capital a deposit taker must have as a percentage of its risk-weighted assets (**RWAs**). Deposit takers are required to have more capital (such as equity) for riskier loans to provide a larger buffer to absorb potential losses. Risk weights help determine the amount of capital the deposit taker is required to have by reflecting the risks of underlying lending.

⁷⁷ Section 3(1) of the DTA.

⁷⁸ Section 4 of the DTA.

Our framework for calculating risk weights is based on the Basel Framework that sets international standards and minimums for bank capital requirements.⁷⁹ Under this framework, there are two approaches used to calculate risk weights:

- The **standardised approach**, where risk weights are set based on the broad characteristics of loans, such as the loan-to-value ratio (**LVR**) for residential mortgage lending.
- The **internal ratings-based (IRB)** approach, where deposit takers accredited by the Reserve Bank are authorised to calculate credit risk weights using their own internal risk models, enabling them to get a more precise measure of the riskiness of lending. Currently only Group 1 deposit takers have been approved to use this approach, but others can apply.

Problem definition

In both the feedback on the Deposit Takers Core Standards consultation⁸⁰ and submissions to the Finance and Expenditure Committee's (**FEC's**) inquiry into banking competition,⁸¹ some deposit takers highlighted that the Reserve Bank's standardised credit risk weights have not been reviewed for at least 10 years. They argued for more granular, lower risk weights in several areas including residential mortgage, corporate, agricultural, collective and social housing lending and lending for housing on Māori freehold land. Similar points were raised in the Commerce Commission's recommendations in their market study into personal banking services,⁸² and in the Minister of Finance's December 2024 Letter of Expectations to the Reserve Bank.⁸³ In addition, the Primary Production Select Committee has been particularly focused on assessing the impacts of risk weights on lending to the rural sector.

Deposit takers' feedback strongly indicated that they consider the existing standardised risk weights for residential mortgage, corporate and rural lending to be too high, relative to the underlying lending risk. In addition, the Reserve Bank's current approach to standardised risk weights is lacking granularity, particularly for less-risky loans, such as residential mortgage lending (**RML**) with low LVRs. This may mean that these standardised risk weights are not sufficiently reflecting the actual risk of these types of loans – for example, RML with LVRs up to, and including, 80% are all currently assigned the same risk weight. This is a key issue that we want to address – ensuring that risk weights reflect the actual risk faced by deposit takers in the New Zealand context.

The lack of granularity in our current approach to standardised risk weights is out-of-line with the current international standards set by the most recent Basel Framework. Adopting a more granular approach to standardised risk weights for lower risk lending will also, in principle, bring deposit takers that are using the standardised approach more in line with those using IRB modelling – which is desirable if some of the current standardised risk weights are too high. Furthermore, updating standardised risk weights to be more granular and reflect the risks of the underlying

79 Basel Committee on Banking Supervision. (2025). *Basel Framework*. bis.org/baselframework/BaselFramework.pdf

80 Reserve Bank of New Zealand. (2024). *Deposit Takers Core Standards: Policy proposals*. https://consultations.rbnz.govt.nz/dta-and-dcs/deposit-takers-core-standards/user_uploads/deposit-takers-core-standards-consultation-paper-1.pdf

81 New Zealand Parliament. (2025). *Submissions and Advice*. <https://www.parliament.nz/en/pb/sc/submissions-and-advice/>

82 Commerce Commission. (2024). *Market study into personal banking services*. <https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-personal-banking-services>

83 Reserve Bank of New Zealand. (2024). *Letter of expectations December 2024*. <https://www.rbnz.govt.nz/hub/publications/corporate-publications/letters-of-expectation/letter-of-expectations-december-2024>

lending could help to reduce any distortions that capital requirements might have on the allocation of lending across different sectors.

Overall, we agree that risk weights should reflect the actual risk faced by deposit takers in the New Zealand context. This matches the approach we set out in 2022 when we reviewed a number of aspects of our approach to risk weights.⁸⁴ Therefore, in October 2024, we issued an information request to deposit takers to provide us with more detailed information about their exposures to help inform our analysis of the impacts of changing standardised risk weights. We received their responses in December 2024. We used this data, along with current the Australian Prudential Regulatory Authority (**APRA**) standardised risk weights and Basel capital requirements as benchmarks, to model the proposed changes to standardised risk weights outlined below and the potential impacts these changes may have.

5.2 Proposal for more granular standardised risk weights

Residential mortgages

Proposed changes

Under the current standardised approach, all RML that falls within the same lending category⁸⁵ and has an LVR of 80% or under is assigned the same risk weight. We propose introducing two new categories for lower risk RML: one for RML with an LVR of 50% or under, and one for RML with an LVR of 50.01% – 60%. Table 12 shows our proposed changes in risk weights for these categories.

Table 12: Current and proposed RML standardised risk weights by LVR (not past due)

Type of lending	Current standardised risk weight (%)	Proposed standardised risk weight (%)
Owner-occupier with LVR ≤ 50 NEW	35	25
Owner-occupier with LVR 50.01 – 60 NEW	35	30
Owner-occupier with LVR 60.01 – 80	35	35
Owner-occupier with LVR 80.01 – 90 (no LMI)	50	50
Owner-occupier with LVR 90.01 – 100 (no LMI)	75	75
Owner-occupier with LVR > 100 (no LMI)	100	100
Investor with LVR ≤ 50 NEW	40	30
Investor with LVR 50.01 – 60 NEW	40	35
Investor with LVR 60.01 – 80	40	40
Investor with LVR 80.01 – 90 (no LMI)	70	70

⁸⁴ Reserve Bank of New Zealand. (2023). *Risk weights*. <https://www.rbnz.govt.nz/have-your-say/risk-weights>

⁸⁵ There are different categories for non-property investment and property investment loans, and distinctions for lending with and without Lender's Mortgage Insurance (**LMI**).

Type of lending	Current standardised risk weight (%)	Proposed standardised risk weight (%)
Investor with LVR 90.01 – 100 (no LMI)	90	90
Investor with LVR > 100 (no LMI)	100	100

We considered whether to reduce the risk weight for the lowest LVR category (≤ 50) to 20%, which would align with APRA's approach. However, we ultimately decided that we were not comfortable with setting the risk weight this low. This is currently the risk weight that applies for RML where the loan has Lenders Mortgage Insurance (**LMI**) underwritten by Kāinga Ora. For these loans, any losses incurred by the lender are indemnified by Kāinga Ora. This provides a substantial reduction in risk for the deposit taker and as a result receives a 20% risk weight. We are therefore not comfortable reducing standardised risk weights to 20% for loans without such insurance, regardless of the LVR.

In addition to the changes outlined in Table 12 for RML not past due, we propose aligning the Reserve Bank's past due RML standardised risk weights more closely with APRA and Basel's (generally) higher standardised risk weights for these categories. The main differences in these risk weights would be that:

- Past due owner-occupied RML with LMI moves from its corresponding LVR-based risk weights ranging from 35% - 100% (see Table 12) to a fixed rate of 80%
- Past due investor RML with LMI moves from its corresponding LVR-based risk weight ranging from 40% - 100% (see Table 12) to a fixed rate of 95%
- Past due owner-occupied RML with LMI remains at 100%, but past due investor RML with LMI increases from 100% to 120%

We have used data provided to us by deposit takers through our information request in October 2024 to calculate the impact of these proposed changes to standardised risk weights for RML past due on overall RWAs. The overall share of loans in these categories is very small, making up approximately 0.7% of RML for Group 1 and 2 deposit takers.⁸⁶ As a result, making the proposed changes to RML past due standardised risk weights would make very little difference to the overall RWAs, and therefore capital levels, of deposit takers (approximately 0.2 percentage points). However, it would mean that these higher risk lending categories have a generally higher risk weight assigned to them which is more aligned with the actual risk of the lending.

Analysis

Introducing more granular risk weights for both lower and higher risk RML is supported by evidence from previous Reserve Bank stress tests. The following Tables 13 and 14 show mortgage default rates, loss given defaults (**LGDs**), and expected loss rates for residential mortgage lending in each of the Reserve Bank's 2021 and 2022 bank industry solvency stress tests.⁸⁷

⁸⁶ As at June 2024.

⁸⁷ The 2022 bank industry solvency stress test is the most recent bank industry stress test that the Reserve Bank has conducted that is relevant. We have included 2021 results as a check against idiosyncratic stress that may have been evident in certain sectors in the 2022 stress test due to the type of scenario used. The 2023 solvency stress test was desk-based only, and in 2024 we conducted a

Table 13: 2021 Bank solvency stress test mortgage default rates, LGDs and loss rates by LVR

LVR (%)	Default rate (%)	LGD (%)	Loss rate (%)
0 - 60	1.7	7.4	0.1
60.01 - 70	2.4	13.5	0.3
70.01 - 80	2.8	22.2	0.6
80.01 - 90	3.8	25.4	1.0
> 90	4.4	34.1	1.5

Table 14: 2022 Bank solvency stress test mortgage default rates, LGDs and loss rates by LVR

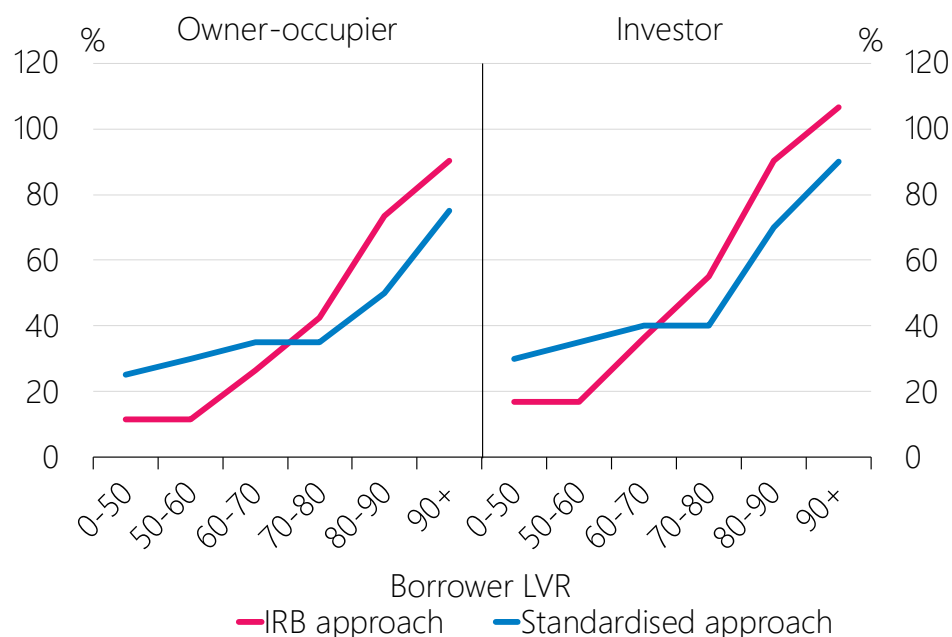
LVR (%)	Default rate (%)	LGD (%)	Loss rate (%)
0 - 40	1.9	7.8	0.1
40.01 - 50	2.5	10.9	0.3
50.01 - 60	3.0	14.3	0.4
60.01 - 70	3.8	20.7	0.8
70.01 - 80	4.5	27.8	1.2
80.01 - 90	6.5	35.3	2.3
> 90	6.2	48.2	3.0

These results show that during periods of stress, default rates, LGDs and loss rates on RML with an LVR of 80% or higher can more than double in comparison to RML with an LVR of 60% or under. Therefore, these results support splitting RML with LVRs of less than or equal to 80% into more granular risk weight categories to more accurately reflect the relative risk of the lending, particularly for lending with an LVR of 60% or under. The results also support maintaining our current higher risk weights for riskier lending with an LVR of 80% or above, given the increased levels of defaults, LGDs, and losses shown for high-LVR RML.

Additional granularity at the low-LVR end of RML would also bring the standardised approach more in line with the IRB approach to risk weights for RML. Figure 18 shows the risk weights for the four IRB deposit takers' residential mortgage portfolios, split across the owner-occupier/investor and LVR dimensions, as well as a comparison to our proposed standardised risk weights for RML.

reverse stress test instead. We are awaiting the results of the 2025 bank industry solvency stress test, which will be received around the same time as this consultation closes, at which time we will be able to update this analysis with the most recent results.

Figure 18: IRB average vs. proposed standardised risk weights for RML, by LVR and borrower category



Source: RBNZ analysis of RBNZ *Capital Satellite* survey returns.

Note: IRB data is as at June 2024.

Loans with LVRs below 60% tend to have less time until maturity and generally have stronger debt-servicing ratios (due to borrower income growth and principal repayments since they took out the loan). Average IRB risk weights for this category as at June 2024 were in the 10% – 15% range. Conversely, higher LVR loans on average receive IRB risk weights in the 60% – 90% range, which represents a sharp increase compared to loans with LVRs below 60%. We believe a similar approach makes sense for the standardised approach.

The relationship between LVR and risk weights is stronger under the IRB approach than the standardised approach – since IRB deposit takers model the risk characteristics of each loan, they can produce risk weights that more accurately reflect a borrower’s individualised credit risk.⁸⁸ Adding the two new standardised risk weight categories for RML with LVRs at or below 50% and RML with LVRs between 50.01 – 60% for both owner-occupiers and investors would have the effect of bringing the standardised approach to RML risk weights more in line with the IRB approach. This would also therefore better align standardised risk weights for RML with actual risk.

Therefore, the new categories outlined in Table 12 above would not only introduce additional granularity into our standardised risk weight approach, but also allow risk weights which more accurately reflect the underlying risk of different types of lending (i.e., lower risk weights for the lower risk ends of low-LVR lending) while maintaining our higher risk weights for riskier high-LVR lending, and increasing risk weights for past due lending. This approach would also bring us more in line with international (i.e., APRA and Basel) approaches to standardised risk weights.

⁸⁸ Cassino, E., & Lilly, C. (2024). How risk weights affect bank lending. *Reserve Bank of New Zealand Bulletin*, 87(6).
<https://www.rbnz.govt.nz/hub/publications/bulletin/2024/how-risk-weights-affect-bank-lending>

Corporate

Proposed changes

Under the current standardised approach, all corporate lending without a credit rating is assigned the same risk weight (100%). This is likely to capture all small and medium enterprise (**SME**) retail and corporate lending as it is generally not cost effective for SMEs to seek and maintain a credit rating.⁸⁹

In order to introduce more granularity into corporate lending, we propose introducing two new corporate exposure categories to align the standardised risk weights for SME lending in New Zealand with APRA and Basel requirements. The two new categories would be SME retail and SME corporate, with risk weights of 75% and 85% respectively.

Analysis

Previous stress tests have shown that the loss rates for SMEs are likely to be less volatile under stress than for large corporates. Whilst SMEs might be more likely to default, their losses are expected to be smaller than large corporates' losses given the relative size of each of these exposures and levels of security coverage.

Figure 19 shows the default rates, loss given defaults, and loss rates for large corporates and SMEs in each of the Reserve Bank's 2021 and 2022 bank industry solvency stress tests.

Figure 19: 2021 and 2022 Bank solvency stress test results for SME and large corporate lending



Source: 2021 and 2022 RBNZ Bank Solvency Stress Test submissions, RBNZ estimates.

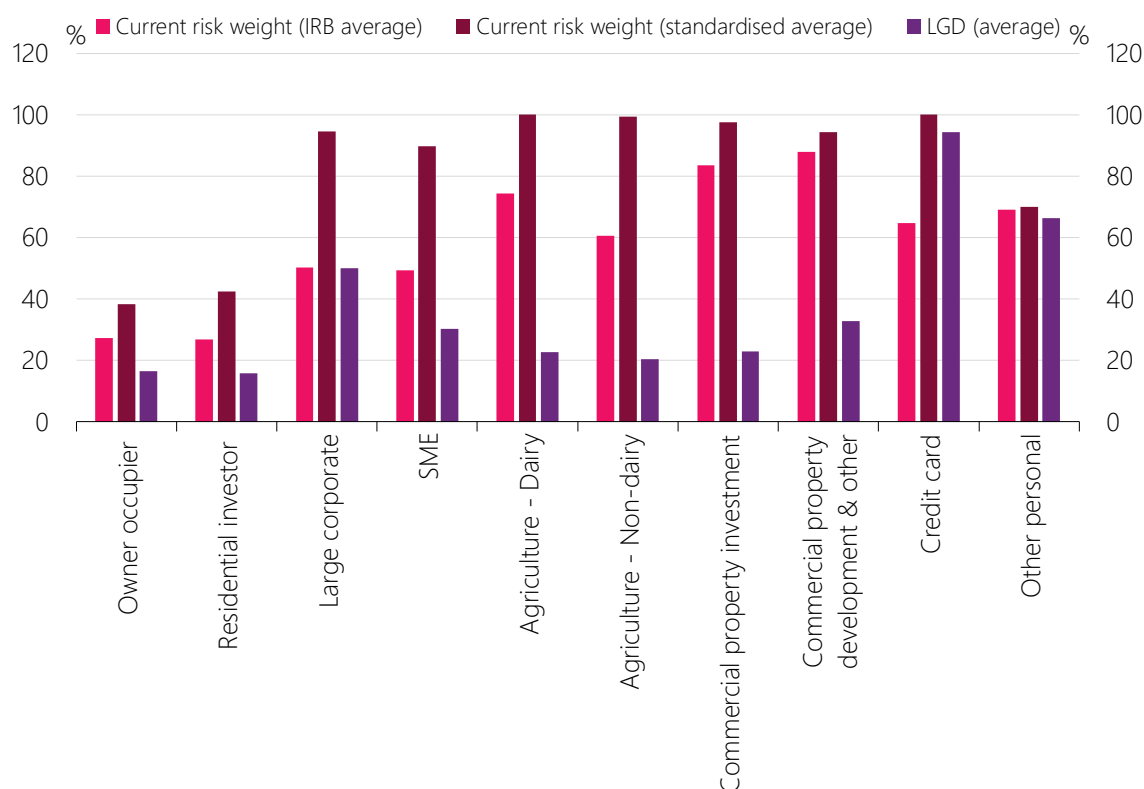
⁸⁹ B4.3 in BPR133: IRB Credit Risk RWAs creates a subcategory of exposures to SMEs which are exposures to small and medium-sized entities where the bank's total exposure to the entity is less than \$1 million. Any exposures that would be classified as RML are excluded. See Reserve Bank of New Zealand. (2024). *BPR133: IRB Credit Risk RWAs*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/banking-supervision-handbook/bpr133-irb-credit-risk-rwa-1-july-2024pdf.pdf>.

The results show that during periods of stress, while SMEs appear to have a slightly higher default rate than large corporate exposures, the LGD for large corporates tends to be significantly higher than for SMEs. This indicates that, in percentage terms, lenders do not expect to recover as much of their large corporate lending compared to SME lending, should these exposures default.

The loss rates – which show how much the lenders expect to lose across each lending portfolio during such stress events – remain consistent for SME lending across both stress tests (1.5%), while for large corporates they range between 1.1 – 1.8%.

In addition, Figure 20 shows that standardised risk weights for large and SME corporate lending are significantly higher on average than the IRB risk weights and have among the largest discrepancies on average between the two risk weight approaches of any of the types of lending. Given that IRB deposit takers are more able to accurately reflect credit risk in their risk weights, this discrepancy may indicate that the standardised approach is overestimating the risk of these types of corporate lending.

Figure 20: 2021/2022 Bank solvency stress test average LGD and current risk weights by lending sector



Source: 2021 and 2022 RBNZ Bank Solvency Stress Test submissions, RBNZ estimates.

Along with the more consistent expected loss rate and lower loss given defaults for SME lending mentioned above, we believe this evidence supports introducing granularity in corporate lending by creating separate, lower standardised risk weight categories for SMEs.

Agriculture

Proposed changes

Currently, under the standardised approach, agricultural lending is likely captured under unrated corporate lending as, like SMEs, it is unlikely that they have pursued a credit rating due to the cost and barriers involved. This means that all agricultural lending likely receives the same risk weight under the standardised approach (100%), regardless of how risky the underlying lending is.

We propose introducing three new exposure categories for agricultural lending to enable lenders using the standardised approach to assign risk weights based on the LVR, which would more accurately reflect the actual riskiness of this type of lending.

We have calibrated the proposed risk weights by considering the existing risk weights that the IRB deposit takers apply to agricultural lending across the LVR buckets.⁹⁰ Table 15 shows the comparison between the average IRB risk weight assigned to each of the LVR buckets and our proposed standardised risk weights.

Table 15: Simple and weighted average IRB risk weights used by New Zealand IRB deposit takers for agricultural lending and proposed standardised risk weights

LVR	Simple average	Weighted average	Proposed risk weight
LVR = <30	23.5%	21.7%	50%
LVR >30 to 50	42.2%	41.8%	75%
LVR > 50	92.5%	92.1%	100%

Analysis

We are proposing to keep the standardised risk weights above the average of the IRB risk weights for several reasons. The IRB deposit takers vary widely in the risk weights they apply to each type of lending, ranging from 17% - 130% depending on the LVR, with the ranges spanning around 20 to 70 percentage points within each bucket. In addition, standardised risk weights are generally calibrated at a more conservative level than IRB as they tend to be less precise than IRB risk weights (which can be calibrated to a wider range of bank, borrower and portfolio risk characteristics).

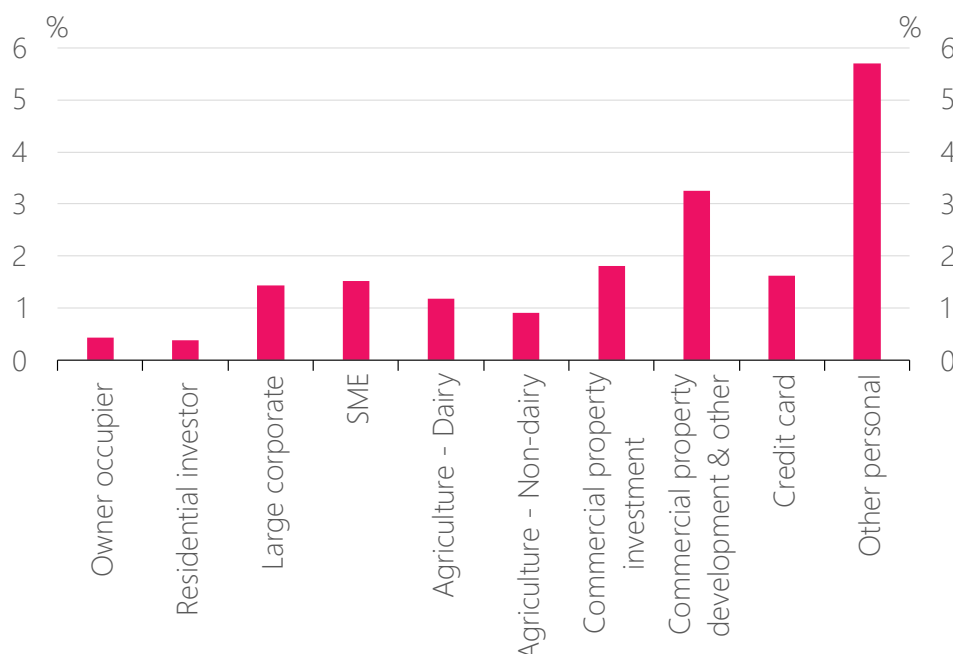
We are proposing to keep the low-LVR risk weights higher for agricultural lending than those applied to low-LVR RML. Even at low-LVRs, the risk profile of agricultural lending is very different to RML due to the difference in types of security held for each type of lending. In addition, agricultural lending is exposed to a range of external and international risks (including exchange rates, international economic conditions and trade policy) that make it higher risk than RML.

This difference in risk profile is also clearly evidenced in our banking industry solvency stress test results. Figure 21 shows that the expected loss rates for different types of agricultural lending could

⁹⁰ Only three of the four IRB deposit takers supplied the IRB risk weights that they apply to the different agricultural lending LVR buckets, so we have used the average IRB risk weights of these three only – the fourth IRB bank only provided the standardised risk weights they use for this lending.

be two to three times higher than for either owner-occupier or investor RML under stress. Therefore, we think it is reasonable to have a proposed starting point of a 50% risk weight for low-LVR agricultural lending with a step up to 75% at the next LVR bucket (as loss rates would likely grow at higher LVRs), given that the lowest proposed RML risk weights begin at 25%.⁹¹

Figure 21: 2021/2022 Bank solvency stress test average loss rate by lending sector



Source: 2021 and 2022 RBNZ Bank Solvency Stress Test submissions, RBNZ estimates.

However, the value of the security in agricultural lending often also means that it is lower risk than other types of corporate lending. Evidence from these stress tests supports this, showing that overall agricultural lending can be less risky than other types of corporate lending during periods of stress.

Figures 20 and 21 (above) show that during the periods of stress the expected average loss rate and LGD for agricultural lending was lower than that of other types of corporate lending in both the 2021 and 2022 bank industry solvency stress tests. Figure 20 also shows that the standardised risk weights currently applied to agricultural lending may be disproportionately high, given the underlying risk implied by these results comparative to some of the other types of lending. Therefore, this supports introducing more granularity into corporate lending via new risk weights specifically assigned to agricultural lending.

However, if we adopted more granularity in standardised risk weights for agricultural lending, we would need to carefully define the 'value' for the LVR calculations to provide consistency with how the value is currently calculated in IRB modelling of agricultural risk weights. For example, IRB deposit takers must generally 'scale' down the value of the security used for the lending, to reflect uncertainty about what value is like to be recovered. We intend to apply similar considerations for the standardised proposals.

⁹¹ Our stress test results do not contain a breakdown for agricultural lending by LVR, so we are unable to compare loss rates at different LVRs for agricultural lending. This means we cannot more accurately calibrate the agricultural risk weights to actual risk at the more granular LVR level using these results.

- Q29** Do you agree that the Reserve Bank should introduce more granular standardised risk weights for mortgage, corporate and agricultural lending?
- Q30** Do you have any comments on the proposed changes to standardised risk weights for mortgage, corporate and agricultural lending?
- Q31** For deposit takers: Can you quantify the overall and sectoral impact that the proposed changes to standardised risk weights for residential mortgage, corporate, and agricultural lending would have on your institution?
- Q32** Would you expect more granular residential mortgage lending risk weights to lead to more differentiation in loan pricing to borrowers?
- Q33** For deposit takers: Can you provide a lending breakdown for your institution by the following corporate sectors: rating, small and medium-sized enterprise retail, small and medium-sized enterprise corporate, and other unrated corporate?

Commercial property and personal lending

Figures 20 and 21 above also show that there are types of lending that may have elevated risks compared to others. The stress test results show that lenders expect significantly higher losses for aspects of commercial property and unsecured personal lending than most other types of lending. Therefore, there is potentially scope to add more granular, higher risk weights for these types of lending in order to more accurately reflect their comparative inherent riskiness.

Currently, commercial property exposures are captured as part of corporate lending, which means risk weights are assigned according to whether they have a credit rating (and, if so, what that credit rating is). Therefore, it is likely that there are unrated SME providers of commercial property which could be captured in our proposed lower risk weights for SMEs, which would likely result in lenders underweighting the underlying risk of this type of lending. As a result, we propose creating a new category for commercial property exposures to allow lenders to more accurately risk weight the lending according to the comparatively high risk it presents. We believe a starting point of a 100% risk weight could be appropriate to accurately reflect this risk, but we need more detailed data to be able to assess the appropriateness and potential impact of such a change.

Personal lending is captured under 'other' exposures and already has high risk weights compared to other types of lending, which is the case for both standardised banks and Group 3 deposit takers. However, we consider that there could be scope to move the standardised risk weights even higher to more closely align with those applied by Group 3 deposit takers (100% for secured personal lending; 150% for unsecured). This would likely make very little difference to RWAs, and therefore capital levels, as banks tend to have minimal personal lending exposures. However, we believe this would better reflect the greater underlying risk of this type of lending.

We currently have very limited detailed data on commercial property and personal lending, meaning it is difficult to assess any potential impacts from changing these risk weights or introducing additional granularity via new exposure categories. Therefore, we are seeking more

information from deposit takers about their exposures to these categories and the risk weights they apply via this consultation.

- Q34** Do you agree with creating a new standardised risk weight category for all unrated corporate commercial property lending?
- Q35** For deposit takers: Can you quantify the impact that a 100% risk weight under the standardised approach on all unrated commercial property lending would have on your institution?
- Q36** Do you have any comments on increasing risk weights for personal lending?
- Q37** For deposit takers: Can you quantify the impact that a 100% risk weight on secured personal lending and a 150% risk weight on unsecured personal lending would have on your institution?
- Q38** For deposit takers: Can you provide a lending breakdown for your institution for the following sectors: commercial property (investment, development, and a loan-to-value ratio breakdown within these categories), and personal lending (secured, unsecured, credit card and other)?

Summary of potential impacts of changes to standardised risk weights on deposit takers

Lower and more granular risk weights better reflect actual lending risk, but mean less capital for any given capital ratio requirement.

A more granular approach to standardised risk weights would allow us to be more responsive to the real risk posed by certain types of lending. However, changes that reduce standardised risk weights, such as those we are proposing, could increase the risks to the soundness and safety of individual deposit takers. This is because deposit takers would need a lower dollar amount of capital to satisfy capital ratio requirements under the proposed standardised risk weights, relative to how much they would need if average risk weights were higher. This would be contrary to one of the additional purposes of the DTA – to promote the safety and soundness of each deposit taker (section 3(2)(a)).

However, lower risk weights for low-LVR and lower risk RML could reduce the average risk across the lender's portfolio as a whole, potentially offsetting this effect. These two factors work in opposite directions, so the overall impact will be driven by the interaction of these factors. In addition, we take the proposed lower standardised risk weights (and lower amount of capital) into account when evaluating the options outlined in Chapter 3.

The maximum impact from the changes to standardised risk weights described below is estimated to be around a 5.7% fall in the overall amount of capital in the system (for Group 1 and 2 deposit takers), although the estimated size of this impact may change as we receive additional information from this consultation.

The numbers in this analysis are our best estimates, but there are data limitations. These limitations mean that the 5.7% impact identified above is an estimate only and should not be considered to be the upper bound of the potential reduction in capital from the proposed changes to standardised risk weights. In particular, we believe the analysis could understate the impact we would have otherwise expected on corporate RWAs from the proposed changes. Therefore, we are seeking feedback on this analysis as part of this consultation, including seeking more detail from deposit takers on their lending breakdowns and the potential impacts from the proposed standardised risk weight changes.

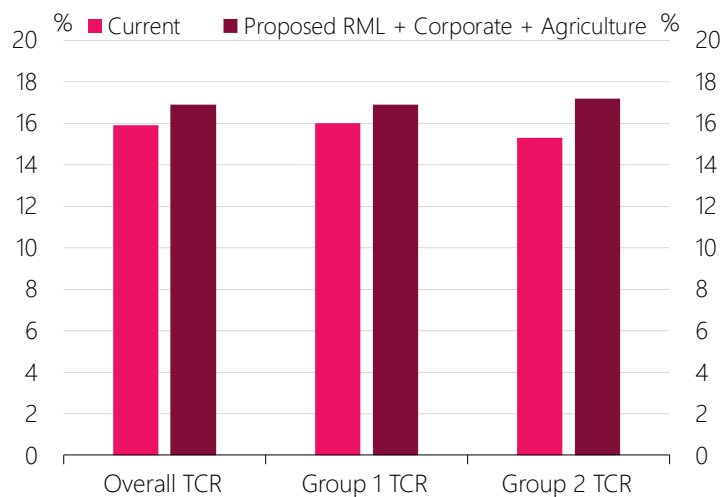
Overall impact on banking sector – Group 1 and 2 combined

As stated above, the proposed residential mortgage, corporate and agricultural standardised risk weights would reduce New Zealand's Group 1 and 2 deposit takers' RWAs by an estimated total of 5.7%. The changes to standardised risk weights for RML contribute approximately 3 percentage points of this reduction, while the changes to agriculture standardised risk weights contribute around 1.7 percentage points and the changes to corporate standardised risk weights contribute approximately 1 percentage point.

However, this impact is not evenly distributed across Group 1 and 2 deposit takers. Group 1 deposit takers' overall RWAs reduce by around 4.9% (a fall of around \$2.9 billion in capital required) and Group 2 deposit takers' RWAs reduce by around 10.9% (a fall of around \$1 billion in capital required), see the following sections for more detail. These results mean that deposit takers would face a lower overall capital requirement compared to if the 2019 Capital Review were to be fully implemented in 2028, thereby allowing deposit takers to reach the minimum total capital ratio (TCR) required much more quickly under the new risk weights than they would under the status quo.

Figure 22 illustrates the impact on Group 1 and 2 deposit takers' TCRs if we were to move from our current standardised risk weights to the risk weights proposed above. The TCR refers to the amount of capital that a deposit taker must have in relation to its risk-weighted exposures and is calculated using a deposit taker's total capital divided by its RWAs.

Capital ratios are a key indicator of the financial strength of a deposit taker, measuring the losses it can withstand relative to the risk of the deposit taker's business. However, in this analysis, the relatively higher TCR associated with the proposed standardised risk weights does not indicate greater financial strength, but is rather a result of the reduction in RWAs (the denominator in the ratio calculation) while holding current capital levels constant.

Figure 22: Deposit takers' total capital ratios under current vs. proposed standardised risk weights

Source: RBNZ estimates.

Group 1

While Group 1 (IRB accredited) deposit takers do not use the standardised approach to calculate risk weights, the changes proposed to standardised risk weights above would also influence risk weight outcomes for this group of deposit takers. This is because we restrict the risk weights calculation outcome in the IRB approach to be no lower than 85% of the outcome for the same exposures in the standardised approach (this is known as the output floor).

Since the proposal would reduce average standardised risk weights, the outcome for IRB deposit takers would also reduce, as 85% of the standardised outcome will now be 85% of a lower number. Therefore, these changes would significantly reduce capital in the system as Group 1 deposit takers would have lower risk weights and consequently would need to have less capital to meet the prescribed capital ratios.

Table 16 summarises the estimated impact of introducing the proposed standardised risk weights on Group 1 deposit takers, showing that the proposed risk weights could reduce Group 1 deposit takers' overall RWAs by around 4.9%.

Table 16: Impact of introducing the proposed standardised risk weights on Group 1 deposit takers

	June 2024 (actual)	Corporate risk weights	RML risk weights	Agri risk weights	RML + Corporate + Agri
Capital \$m	52,593	52,593	52,593	52,593	52,593
RWA \$m	328,083	326,860	318,209	323,100	312,003
% change in RWA		-0.4	-3.0	-1.5	-4.9
Total Capital Ratio %	16.0	16.1	16.5	16.3	16.9
Capital required at 18%	59,055	58,835	57,278	58,158	56,161

	June 2024 (actual)	Corporate risk weights	RML risk weights	Agri risk weights	RML + Corporate + Agri
TCR required to keep overall capital unchanged %		18.1	18.6	18.3	18.9

Group 2

Table 17 summarises the estimated impact of introducing the proposed standardised risk weights on Group 2 (standardised) deposit takers, showing that the proposed risk weights could reduce Group 2 deposit takers' overall RWAs by around 10.9%.

Table 17: Impact of introducing the proposed standardised risk weights on Group 2 deposit takers

	June 2024 (actual)	Corporate risk weights	RML risk weights	Agri risk weights	RML + Corporate + Agri
Capital \$m	7,612	7,612	7,612	7,612	7,612
RWA \$m	49,594	46,956	48,183	48,244	44,195
% change in RWA		-5.3	-2.8	-2.7	-10.9
Total Capital Ratio %	15.3	16.2	15.8	15.8	17.2
Capital required at 18%	8,927	8,452	8,673	8,684	7,955
TCR required to keep overall capital unchanged %		19.0	18.5	18.5	20.2

Group 3

We have also considered the impacts of the lower, more granular standardised risk weights on Group 3 deposit takers.

The 2024 Deposit Takers Core Standards consultation⁹² proposed aligning Group 3 risk weights with the standardised risk weights that will apply to Group 2. We are continuing to propose this approach to Group 3 in this Consultation Paper. In addition, with the more granular, and lower, standardised risk weights discussed in Section 5.2 also applying to Group 3, the reduction in average risk weights for this Group will now be even larger than estimated in the 2024 material. We estimate that this will result in significant drops in RWAs for Group 3, as the existing non-bank deposit taker (**NBDT**) risk weight requirements are more conservative than the revised standardised risk weights in a number of cases, for example for RMLs.⁹³

We have updated the shortfall analysis that was included in the Deposit Takers Core Standards Consultation Paper in May 2024, in which we assessed the impacts of the proposed risk weight

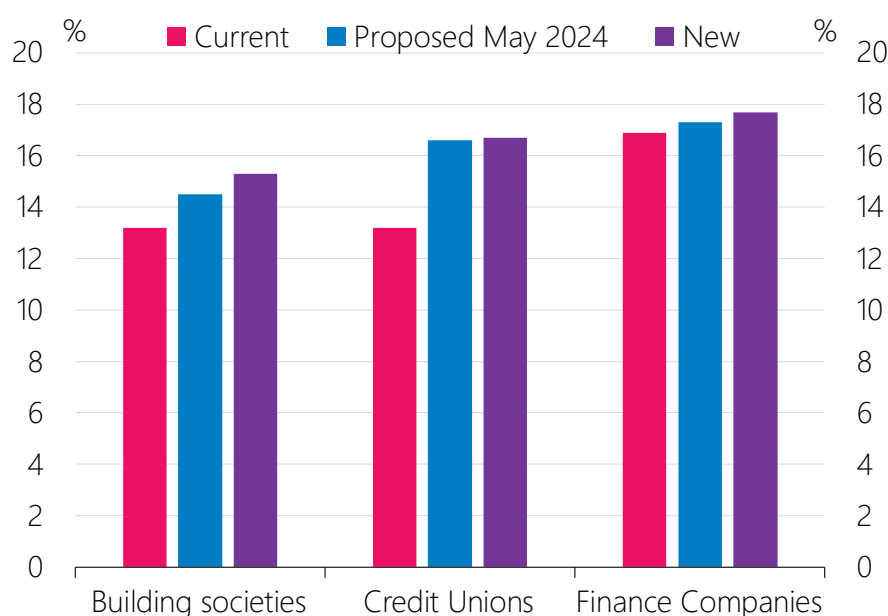
⁹² Reserve Bank of New Zealand. (2024). *Deposit Takers Core Standards: Policy proposals*. https://consultations.rbnz.govt.nz/dta-and-dcs/deposit-takers-core-standards/user_uploads/deposit-takers-core-standards-consultation-paper-1.pdf

⁹³ Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010. <https://www.legislation.govt.nz/regulation/public/2010/0167/latest/DLM3032713.html>

requirements on Group 3. The analysis now includes the revised risk weight proposals in this Consultation Paper, which reflect the proposed more granular risk weights. This results in a further downward shift in Group 3 risk weights, which leads to a further increase in estimate total capital ratios (**TCR**) (Figure 23). As part of our update of the shortfall analysis, we have also incorporated feedback from stakeholders who pointed to some weaknesses in parts of our May 2024 analysis. The main change we made in response to that feedback was to assign more residential mortgage lending to the property investment category.⁹⁴

Lower risk weights are expected to increase reported capital ratios, and we estimate that only one Group 3 deposit taker would fail to meet the proposed buffers (i.e., 4% prudential capital buffer (**PCB**) for Group 3 – see Section 3.3) based on their current level of capital and the revised standardised risk weights. Most Group 3 deposit takers would still be comfortably above the proposed buffer.

Figure 23: Group 3 TCRs under the current, proposed May 2024, and new proposed standardised risk weights



Source: RBNZ estimates.

Note: 'Proposed May 2024' refers to the risk weights proposed in the Deposit Takers Core Standards consultation.

Q39

Do you think the proposed standardised risk weights more closely align with the actual risk of the underlying lending? If not, where do you think the biggest discrepancies are?

⁹⁴ Respondents had suggested the estimates of the benefits of the standardised risk weights (prior to the updated lower and more granular proposal) was too optimistic given a higher amount of past due loans and residential mortgage property investment lending. For detailed analysis of this, see Reserve Bank of New Zealand. (2025). *Deposit Takers Core Standards: Summary of Submissions and Policy Decisions for the Capital Standard*. https://consultations.rbnz.govt.nz/dta-and-dcs/deposit-takers-core-standards/user_uploads/summary-of-submissions-policy-decisions-capital-standard.pdf.

Applying the lower and more granular risk weights before the DTA is fully implemented in late 2028

Currently, the risk-weighted assets approach for NBDTs is set out in the NBDT regulations.⁹⁵ For many categories of exposures, these risk weights tend to be higher than those used in the existing standardised approach, with the proposed new risk weights further widening this gap (Figure 23).

Once the DTA takes full effect, NBDTs (if licensed) would be categorised as Group 3 deposit takers. It is currently proposed that Group 3 deposit takers would adopt the risk categories and weights of the standardised approach.

We are considering whether the standardised risk weights and categories (notwithstanding whether they are lowered as part of this Review) should apply to NBDTs before the DTA is fully implemented and before NBDTs are directly supervised by the Reserve Bank. Two key considerations as part of this process are:

- Whether earlier adoption is consistent with the objectives of this Review and the purposes of the Non-bank Deposit Takers Act 2013 (**NBDT Act**),⁹⁶ specifically, financial stability.
- The system and data collection changes required for NBDTs to comply with new lending categories.

Impact on financial stability

Adopting the standardised risk weights earlier would mean NBDTs would need to have less capital to meet their current minimum capital requirements.

- The proposed lower standardised risk weights (see Table 1) could result in NBDTs meeting the 8% minimum capital ratio requirement⁹⁷ with the equivalent of less than 6.5% of RWAs calculated under current obligations.

Therefore, we are concerned that applying the new and lower risk weights earlier without a corresponding increase in minimum capital would be detrimental to the soundness and efficiency of the financial system.⁹⁸ This is especially the case given the Reserve Bank will only begin direct supervision of these entities once the DTA is fully implemented in 2028.

Compliance costs

The adoption of the standardised approach would change the lending categories used in calculating risk weights. Compared to the current NBDT regulations, the standardised approach would consolidate some lending categories specified in the NBDT regulations. For example, 'property development' and 'other property and commercial' exposures are specified as separate categories in the NBDT regulations, but are not separated from other forms of corporate lending in the standardised approach.

⁹⁵ Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010, pt 3.

<https://www.legislation.govt.nz/regulation/public/2010/0167/latest/DLM3032713.html>

⁹⁶ Non-bank Deposit Takers Act 2013, s 3. <https://www.legislation.govt.nz/act/public/2013/0104/latest/DLM3918915.html>.

⁹⁷ A minimum capital ratio must be included in NBDT's trust deeds and set at not less than 8% for deposit takers with a credit rating and not less than 10% for deposit takers without a credit rating (which currently applies to two deposit takers).

⁹⁸ Non-bank Deposit Takers Act 2013, s 3. <https://www.legislation.govt.nz/act/public/2013/0104/latest/DLM3918915.html>.

The standardised approach would also expand the application for other exposures. For example, increased granularity in LVRs for residential mortgages including an investor/owner-occupier split in the standardised approach that is not part of the NBDT regulations.

These changes may require NBDTs to make substantial changes to their systems or source additional information from borrowers or third parties in order to correctly categorise lending.

Individual entities could be willing to fast track these system changes if it allows for the use of lower risk weights. However other entities, especially those that receive little benefit from the proposed new risk weights, may be unable or unwilling to compromise on the usual 12 or so months provided to regulated entities to make system changes.

Proposed approach to transition

The proposed transition path provided in Table 18, is designed as a pragmatic response to balance the desire for equitable treatment across deposit takers and the need for NBDTs to update systems and processes.

We currently estimate that all NBDTs would be operating with over 10% capital with the proposed standardised risk weights, and all but one would be above 13% capital. Therefore, the proposed transition path (Table 18) would result in all NBDTs' current capital levels meeting the requirements under the NBDT Act and regulations up until the DTA licensing process (if they pursue this).

As part of this consultation, we are seeking a better understanding of the desired lead-in time NBDTs would require to adopt the proposed standardised risk weight categories and updated minimum capital ratio, along with any additional evidence of the costs and benefits of the proposed risk weights.

Table 18: Proposed transition path for Group 3 deposit takers

Subject to the adoption of a 13% total capital ratio for 2028:

Time (years 1 Oct – 30 Sept)	Minimum capital ratio (%)	Change since prior financial year (%)
2025-26 (current)	8	
2026-28 (set under NBDT regulations)	10*	+2
2028-29 (set under DTA Capital Standard)	11**	+1
2029-30	11	No change
2030-31	12	+1
2031-(final)	13	+1

Note: *The 2% addition for credit rating exempt NBDTs would continue to apply, that is, for those NBDTs the minimum would increase to 12%. An additional 1% was proposed as part of the Deposit Takers Core Standards consultation to apply from 2028 and beyond. **If the proposal is progressed, following the issuance of the Capital Standard, a 9% minimum would apply with the additional amount making up the prudential capital buffer (PCB). In 2028-29 the 11% would consist of the 9% minimum and 2% PCB – the PCB would increase to 4% in 2031.

Early adoption of risk weights and amendments to the minimum capital ratio would require amendments to the NBDT regulations. Regulations relating to capital ratios⁹⁹ are made by the Governor-General, on the advice of the Minister of Finance, given in accordance with a recommendation from the Reserve Bank. The Reserve Bank will therefore provide advice to the Minister of Finance on any amendments to the current regulations, but ultimately, it is not the Reserve Bank Board's decision to make.

- Q40** For deposit takers: Is there a desired lead-in time to adopt the proposed standardised risk weight categories and updated minimum capital ratio? What are the expected costs (and their magnitude) to systems and processes of the proposed standardised risk weight categories?
- Q41** Is there anything else you think we should consider when contemplating changes to standardised risk weights or analysing their impacts?
- Q42** Do you think the proposed approach to standardised risk weights aligns with the main purpose of the Deposit Takers Act 2023 (section 3(1)) and the additional purposes (section 3(2))?¹⁰⁰

5.3 Community housing providers, co-operatives and whenua Māori risk weights (standardised and IRB)

In 2024 we committed to reviewing the approach to risk weights for community housing providers (**CHPs**) and co-operative housing, and lending secured by whenua Māori.¹⁰¹ This was in response to topics raised by respondents in their feedback to the Capital Standard proposals in the 2024 Deposit Takers Core Standards consultation, and in the Commerce Commission's market study into personal banking services.¹⁰² It was also covered by the Minister of Finance's December 2024 Letter of Expectations to the Reserve Bank.¹⁰³

This section covers our analysis of risk weights across these topics and identifies preferred options. We have also identified some gaps where we are looking for additional information before final decisions are made later in 2025.

99 Non-bank Deposit Takers Act, s 33. <https://www.legislation.govt.nz/act/public/2013/0104/latest/DLM3918915.html>

100 Deposit Takers Act 2023, s 3. <https://legislation.govt.nz/act/public/2023/0035/latest/LMS469449.html>

101 Whenua Māori can take a number of different forms, including whenua owned by a Māori land trust, a Māori incorporation, or directly by the individuals themselves. For more information about different ownership forms, see Reserve Bank of New Zealand. (2024). *Practice Note for Lending on Whenua Māori*. <https://www.rbnz.govt.nz/about-us/how-we-work/te-ao-maori/lending-on-whenua-maori>

102 Commerce Commission. (2024). *Market study into personal banking services*. <https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-personal-banking-services>

103 Reserve Bank of New Zealand. (2024). *Letter of expectations December 2024*. <https://www.rbnz.govt.nz/hub/publications/corporate-publications/letters-of-expectation/letter-of-expectations-december-2024>

Community housing providers and co-operatives

Community housing providers are generally not-for-profit groups meeting housing needs through a range of affordable rental and home ownership options. CHPs provide around 16% of all of New Zealand's social housing places, or around 14,000 houses.¹⁰⁴

Some CHPs are registered and regulated by the Community Housing Regulatory Authority (**CHRA**), an independent agency within the Ministry of Housing and Urban Development (**HUD**). Organisations which demonstrate the ability to meet the CHRA's Performance Standards become 'registered Community Housing Providers'.

Since 2014, registered CHPs have been able to provide homes to those on the Public Housing Register and apply to access the Income Related Rent Subsidy (**IRRS**). The IRRS is a programme run by the Ministry of Housing and Urban Development (**HUD**), where the amount of rent paid by someone living in public housing is based on their income. This is called Income Related Rent (**IRR**) and means the tenant pays some rent (their IRR) and the government pays some of their rent, generally directly to their landlord.¹⁰⁵ The subsidy covers the difference between the market rent and the tenant's IRR, set by the Ministry of Social Development (**MSD**). We understand that the average IRR paid by social housing tenants is around \$165 per week, and that it generally makes up around 25% of the market rent, with the government meeting the rest of the rental cost.¹⁰⁶

Housing co-operatives (also referred to as 'co-operative housing') is a concept which shares similar lending risks with CHPs. A typical housing co-operative is a legal entity with "members who gain a permanent right to occupy a dwelling, usually, but not always, in return for affordable rent".¹⁰⁷ Commonly, residents are also co-operative members and therefore are able to collectively make decisions about the co-operative and its governance.

Unlike CHPs, there is no regulation of housing co-operatives and no government funding. As a result, they are not guaranteed payment of a market rent. Although the rent charged is usually below market rent, rent is set at a rate that covers property expenses and maintenance.

Problem definition

The evidence we have considered indicates that the current risk weights generally faced by CHPs and co-operatives are high, relative to actual risk. This is true in the standardised approach and the IRB approach to credit risk. The impact of this is that deposit takers may apply a higher risk weight for this type of lending, potentially leading to a higher funding cost and higher interest rates for borrowers. This may reduce the diversity of housing providers.

104 For more information, see Ministry of Housing and Urban Development. (2025, June 30). *The Housing Dashboard*. <https://www.hud.govt.nz/stats-and-insights/the-government-housing-dashboard/public-homes>.

105 Work and Income. (n.d.). *Calculating your rent payments*. <https://www.workandincome.govt.nz/housing/live-in-home/live-in-public-housing/calculating-rent-payments.html>

106 See Figure 4 in Ministry of Social Development. (2023). *Social Outcomes Model – Social Housing system insights*. <https://www.msd.govt.nz/documents/about-msd-and-our-work/publications-resources/research/benefit-system/social-outcomes-model-2023-housing-system-insights-report.pdf>.

107 Mitchell, I., & Savile-Smith, K. (2023). *Adaptation and Resilience – Lessons in Co-operative Housing from the Peterborough Street Co-operative, Report for Affordable Housing for Generations - Component E*. <https://homesforgenerations.goodhomes.co.nz/wp-content/uploads/2023/10/2023-Rental-cooperatives-Peterborough-street-FINAL1.pdf>

Table 19 below summarises the main options available in the current framework for categorising borrowing to CHPs (or co-operatives):

Table 19: Possible exposure categories and risk weights for lending to CHPs

Category	Current Treatment	Comment
Residential mortgage loan (RML)	Standardised: Linked to LVR. For owner occupied there is a risk weight of 35% for LVRs of less than 80%. For property investment the equivalent risk weight is 40%. IRB: Not available.	Our understanding is that deposit takers using the standardised approach will generally not classify loans as RML once the number of dwellings covered by the loan exceeds a numerical threshold that they set. This is generally based on their own assessment of when lending is more like corporate activity. If the deposit taker considers that RML is a suitable classification, the risk weight will be based on the LVR of the lending to the CHP or co-operative. In the IRB approach RML must fit in the retail category, which requires pooling of homogenous loans. Lending to CHPs and co-operatives is unlikely to be homogenous and therefore is not eligible for IRB modelling.
Corporate	Standardised: Linked to credit rating of borrower. 100% risk weight if no credit rating. IRB: Rated within a deposit taker's approved model.	It is unlikely that any CHPs or co-operatives have a credit rating. As a result, the standardised framework will apply a 100% risk weight for any CHP or co-operative lending that is classified as corporate. The 'corporate' exposures models used by IRB deposit takers will likely generate risk weights of less than 100%, especially if the borrower has high security. However, the 85% output floor effectively limits the IRB outcome to an 85% risk weight (i.e., 85% of the standardised risk weight of 100%).
Income-Producing Real Estate (IPRE)	Standardised: Not available. IRB: Requires use of 'Supervisory Slotting', with a risk weight floor of 70%.	The IRB approach provides a category within 'Supervisory Slotting' that covers IPRE. Lending to CHPs or co-operatives will often be eligible for this treatment. A range of requirements must be met for the risk weighting of this category of lending. While a 70% risk weight is possible in IPRE, the ultimate outcome is constrained by the output floor.

We estimate that the 70% risk weight under the IPRE approach adds an extra 0.4 percentage points to the interest rate faced by a CHP, compared with treating the borrowing as property investment RML. A 100% risk weight, as in the standardised corporate approach, adds a further 0.4 percentage points, making the total impact of using the standardised corporate approach an additional 0.8 percentage points on the interest rate compared with treating the borrowing as property investment RML.

Assessment of risk of CHP and co-operative lending

Table 20 below compares characteristics of CHP and co-operative lending with other forms of lending. The table concludes that the existing risk weights are too high.

Table 20: Comparison of CHP/co-operative lending with other forms of lending

Factor	Assessment
Is CHP and housing co-operative lending lower risk than lending to a business, including other forms of real estate?	Yes. In the case of CHPs, the combination of their charitable purpose, government funding, minimal rent arrears risk, and robust underlying security suggests that the risk is likely to be lower than business lending, supporting different treatment compared with business lending. In the case of housing co-operatives, the ownership structure means that co-operatives are exposed to the higher risk of vacant properties or falls in rent, like private sector landlords. However, co-operatives are likely to collect rent from a range of households and failure to pay by any one household is less likely to affect the capacity of a co-operative as a whole to make mortgage payments. This provides a form of diversification of risk for co-operatives and suggests default is less likely than other forms of lending. Conclusion: standardised corporate risk weights are too high for CHPs and housing co-operatives.
Is CHP and housing co-operative lending lower risk than lending to a private landlord?	Uncertain. In the case of CHPs, the combination of their charitable purpose, government funding, minimal rent arrears risk, and robust underlying security suggests that the risk is likely to be lower than lending to private landlords, supporting different treatment. In addition, as noted above, co-operatives might be less exposed to the financial problems of a single member, especially if the co-operative has other resources that it can draw on to meet mortgage payments. However, the scale (for example, multi-units) creates risks that a small-scale landlord does not face. For example, CHPs and housing co-operatives need to manage maintenance, security and staff. They are therefore more exposed to operational management risks. Regardless of all these factors, the lender has the property as security. We have not identified a compelling reason for why the risk weight should be higher than residential borrowing for investment purposes, so long as the service delivery contract remains in place. Conclusion: risk weight should be no higher than for residential property investment lending.
Is CHP and housing co-operative lending higher risk than lending to an owner-occupier RML?	Yes. With guaranteed income, the risk to the CHP and housing co-operative is lower than an owner-occupier who could lose their job or become unable to work. However, the CHP or housing co-operative may manage a large number of properties and will ultimately have additional costs associated with this. These considerations are not relevant for an owner-occupier. We consider CHP and housing co-operative lending to therefore be higher risk than owner-occupied RML lending. Conclusion: risk weight should be higher than owner-occupier RML.

International approaches

Basel III provides countries discretion to treat CHP lending as RML in both the standardised and the IRB approaches. Australia has utilised this discretion for standardised risk weights but not in the IRB approach. In their standardised approach, APRA allow deposit takers to treat public housing exposure as an 'other' standard residential mortgage under the standardised approach. This is their category that is classified as RML, but is not owner-occupied RML. In their IRB framework, ADIs must treat public housing exposures as IPRE.¹⁰⁸

Our understanding is that some Scandinavian countries have used this Basel discretion to allow banks to treat CHPs and housing co-operative arrangements as RML for the purposes of IRB models. This likely reflects the wider use of such approaches in those countries, making it more suitable for treating as part of a homogeneous pool of loans for modelling purposes.

With only small numbers of CHPs and housing co-operatives in New Zealand, we are not comfortable allowing IRB models to treat the lending as RML. This would see it 'pooled' with other forms of RML despite being quite different from that lending.

Options

The preferred option (Option 3 in Table 21 below) takes a different approach. There would be a separate category, with its own specified risk weights, linked to LVRs.

This effectively replicates the risk weights from the standardised approach for property investment, including the revisions for those categories discussed in this paper, then applies this to all deposit takers. This would include IRB deposit takers and would require those deposit takers to use the standardised treatment. This has a number of advantages:

- Enhances transparency by setting and disclosing the category of lending.
- Avoids ambiguity where lenders might default to corporate categories if they are uncertain about treating lending as RML.
- Avoids differences between standardised and IRB approaches in a category of lending that would be difficult to accurately model.
- Sets a clear definition of eligible CHP and co-operative housing lending, reducing the risk of ineligible lending receiving the same treatment.

We propose that options treat this lending the same in both the standardised and IRB approaches. We have identified the following options.

Table 21: Options for approach to CHP and housing co-operative risk weights

Option	Approach
Option 1	Status quo.
Option 2	Treat all lending to CHPs and housing co-operatives as RML, excluding lending for property development.

¹⁰⁸ Australian Prudential Regulation Authority. (2020). *Response to Submissions: A more flexible and resilient capital framework for ADIs*. <https://www.apra.gov.au/sites/default/files/2020-12/Response%20to%20submissions%20paper%20-%20A%20more%20flexible%20and%20resilient%20capital%20framework%20for%20ADIs.pdf>

Option 3 (preferred)	Create a new standardised category of risk weights for CHPs and housing co-operatives and require IRB deposit takers to use the standardised risk weight. This would be separate from RML.
--------------------------------	--

Option 2 is similar to the APRA treatment, which allows authorised deposit-taking institutions (**ADIs**) to treat CHP lending as 'other standard' RML under its standardised framework, which is separate from owner-occupied RML.¹⁰⁹ In our framework this would be equivalent to treating it as property investment RML. Under Option 2 this treatment would also be extended to housing co-operative lending.

Option 2 would allow deposit takers to treat CHP lending in the same way as RML. While we have not worked out the exact detail of how this would work for the IRB approach, we expect that IRB deposit takers would not be able to treat lending to CHPs and housing co-operatives as RML under the current specifications for IRB models in New Zealand. This is because, unlike some other countries, these forms of housing tenure are not common in New Zealand and modelling this type of lending as RML would currently require loans to be 'pooled', and 'homogenous'. CHP lending does not meet these requirements. This option would therefore require some loosening of the current approach to retail RML by IRB deposit takers, which would create a significant risk and could undermine the IRB model approach as it is likely that IRB deposit takers would not have enough statistical data to manage these exposures on a pooled basis as part of their models.

Option 3 would create a completely new set of exposures in the standardised framework and would require IRB deposit takers to also use this category of exposures. This set of exposures would apply to both CHP and housing co-operative lending. It is also possible that papakāinga developments may also qualify as a CHP or co-operative and could also benefit from the new category.¹¹⁰

The key issue for Option 3 is to determine the appropriate risk weight. To make this assessment we have considered the features of this lending compared with other types of lending. Based on this assessment, we have concluded that the risk of the lending is similar to that for property investment RML.

There is not an exact match, and risk will vary across different forms of lending. For example, some CHPs with long-term Crown contracts may be lower risk than small housing co-operatives. However, designing multiple categories to cover this heterogeneity is unlikely to be useful given the small scale of lending.

Option 3 is the most highly ranked of the options and is our preferred approach for the following reasons:

- Alignment of risk weight with risk.
- Applies to similar types of lending with similar risk levels (CHPs and housing co-operatives).

¹⁰⁹ Australian Prudential Regulation Authority. (2020). *Response to Submissions: A more flexible and resilient capital framework for ADIs*. <https://www.apra.gov.au/sites/default/files/2020-12/Response%20to%20submissions%20paper%20-%20A%20more%20flexible%20and%20resilient%20capital%20framework%20for%20ADIs.pdf>

¹¹⁰ Papakāinga refers to housing developments on ancestral Māori land, often including communal living spaces, marae, and shared resources.

- Transparency through having a separate category of exposures that deposit takers would report.
- Simple and does not require different approaches for standardised and IRB approaches.

As a result, the proposed risk weights for Option 3 are the same as for property investment RML.

Impacts

Option 3 would result in a reduction in average risk weights, perhaps by as much as halving the risk-weighted assets for these exposures. We estimate this approach could result in a fall of up to \$100 million in risk-weighted assets.

We also estimate that lending rates for borrowers could fall by 0.4 – 0.8 percentage points.

Table 22: Funding costs for \$100 of lending with different risk weights

	Formula	Standardised risk weight	Average IRB risk weight	Preferred option
Cost of equity		10%	10%	10%
Corporate tax rate		28%	28%	28%
Required return on equity*	A	13.9%	13.9%	13.9%
Cost of debt*	B	4%	4%	4%
Total loan value	C	\$100	\$100	\$100
Risk weight	D	100%	70%	40%
Risk-weighted asset value	E=C x D	\$100	\$70	\$40
Common Equity Tier 1 capital ratio (including D-SIB buffer)	F	13.5%	13.5%	13.5%
Quantity of equity funding	G=F x E	\$13.5	\$9.45	\$5.4
Quantity of debt funding	H=C-G	\$86.5	\$90.55	\$94.6
Weighted average funding cost	I=(A x G+B x H)/C	5.33%	4.94%	4.53%

*For simplicity, a required return on equity of 13.9% and cost of debt of 4% is assumed. In comparison, see Annex E for detailed estimates for these figures.

Q43 Do you agree with the proposed approach for risk weights on lending for Community Housing Providers and housing co-operatives? Will this approach accurately reflect the risk of that lending?

Q44 Do you think the proposed approach for risk weights on lending for Community Housing Providers and housing co-operatives aligns with the main purpose of the Deposit Takers Act 2023 (section 3(1)) and the additional purposes (section 3(2))?¹¹¹

¹¹¹ Deposit Takers Act 2023, s 3. <https://legislation.govt.nz/act/public/2023/0035/latest/LMS469449.html>

Whenua Māori

Background

In 2024, the Reserve Bank published the Improving Māori Access to Capital issues paper.¹¹² This concluded that the unique nature of some Māori economic activity put Māori at risk of missing the full benefits of the financial system and carrying unrewarded risk and cost. We have been assessing the impact of prudential regulation in contributing to these outcomes, with a focus on the treatment of whenua Māori.

Whenua Māori makes up around 5% of land in Aotearoa (1.4 million hectares).

In 2024, the Māori Land Court bench released a practice note for lending money on whenua Māori. The aim of the practice note was to provide clarity for both whānau and lenders on Māori Land Court processes when accessing finance for development activity on whenua Māori.¹¹³

The practice note covers the following:

- How do owners of whenua Māori approve a mortgage?
- How is a mortgage registered against whenua Māori?
- Can a mortgage be registered against the leasehold estate of whenua Māori?
- How does a mortgagee exercise its power of mortgagee sale in relation to whenua Māori?
- What are the Court's powers under the Property Law Act 2007 in relation to whenua Māori?

Proposed approach

The practice note provides increased clarity to borrowers and lenders. However, as the note was published in 2024, it is unclear how much impact this has had on activity to date. We are interested in feedback from stakeholders about whether the practice note has changed their decisions regarding lending or borrowers secured by whenua Māori.

Our assessment is that RML secured by whenua Māori will benefit from the other changes proposed for RML risk weights outlined in Section 5.2. For example, lending at low LVRs will be eligible for the revised standardised risk weights discussed in Section 5.2.

Some lending may also qualify for the new CHP and co-operative exposure categories discussed above, providing additional scope for aligning risk weights with risk.

We have not identified any features of lending secured by whenua Māori that would support lower risk weights, outside of the wider changes discussed above. However, we are open to considering additional evidence and we are therefore seeking further information from stakeholders through this consultation which can be considered before final decisions are made at the end of 2025.

¹¹² Reserve Bank of New Zealand. (2022). *Improving Māori Access to Capital*. <https://www.rbnz.govt.nz/have-your-say/improving-maori-access-to-capital>

¹¹³ Te Kōti Whenua Māori [Māori Land Court]. (2024). *Practice for lending on Whenua Māori*. <https://www.xn--morilandcourt-wqb.govt.nz/assets/Documents/Practice-notes/Banking-Practice-Note.pdf>

Q45	How has the Māori Land Court whenua Māori practice note altered borrowing and lending decisions?
Q46	For deposit takers: How do you treat lending where whenua Māori is the security? Does this affect your assessment of risk?
Q47	Does lending secured by whenua Māori have different risk characteristics than other lending, and if so, how should this be incorporated into prudential requirements? Is this relevant for residential mortgage lending, and/or other forms of lending?
Q48	Will lending secured by whenua Māori benefit from the other changes proposed in this Review?
Q49	Are there other aspects of the prudential framework that could be addressed to more accurately align risk weights with actual risk for lending secured by whenua Māori?
Q50	What are the barriers to borrowing/lending when whenua Māori is used as security?
Q51	For deposit takers: Do you participate in the whenua Māori Lenders Mortgage Insurance underwriting programme run by Kāinga Ora?

Other matters

There are two further issues relating to the design of options where we would like further information and feedback. These are summarised below.

Table 23: Other issues for feedback

Topic	Proposed approach
Coverage of property development	The options are intended to only apply to finished dwellings. We consider the property development phase to be subject to a range of other risks beyond those discussed in this section.
Borrowing by third parties	Borrowing by third parties, with the intention of leasing their properties to CHPs or co-operatives, are not intended to be covered by the options.

Q52	Do you support excluding lending for property development from the proposed approach to risk weights for lending to Community Housing Providers and housing co-operatives?
Q53	Are the risks during the property development and construction phase different from providing accommodation in finished dwellings?

- Q54** Do you support excluding lending to third-party providers (who intend to lease to Community Housing Providers or housing co-operatives) from the proposed approach to risk weights for lending to Community Housing Providers and housing co-operatives?
- Q55** Are the risks of lending by third-party borrowers different from lending directly to Community Housing Providers?

6 Conclusion and next steps

6.1 Conclusion

We intend to make decisions on finalised capital settings by the end of 2025. While this paper seeks feedback on two options for overall capital ratios, we do not set out a preferred option. We are open to stakeholder views that suggest adjusting these options.

To support the international experts' independent reports, we will provide them with all of submitters' feedback on this paper.

Following consultation, we will use stakeholder feedback on this paper and the feedback from our independent international experts, to refine our analysis.

6.2 Next steps

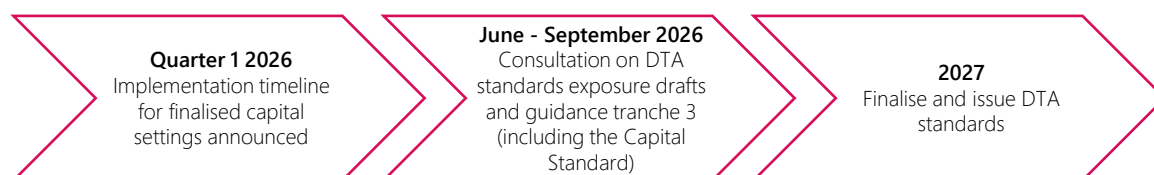
The timeline below illustrates our intended next steps after consultation on this paper closes.



Our international experts will challenge and provide feedback on our analysis through the remainder of the Review. The experts will prepare independent reports on their assessments of our revised capital settings, which will be published on our website at the end of the Review. Final decisions will be based on analysis against the Deposit Takers Act 2023 purposes and principles.

After finalised capital settings are agreed by the Board, we will work to implement the decisions. We intend to prioritise the implementation of any agreed changes so that, where practicable, they come into force ahead of the DTA coming into force. However, the implementation timeline will be agreed and announced once the capital settings have been finalised.

At a high level, the timeline below shows the initial major implementation milestones after the conclusion of the Review. Decisions from the Review will be incorporated into the Capital Standard, which is a Core Standard under the DTA.¹¹⁴ Specific design features of any internal Tier 2 and loss-absorbing capacity (LAC) instruments would be subject to further consultation depending on the outcome of this Review.



We will continue to update our webpage on the Review with the latest information on next steps at <https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-banks/how-we-regulate-and-supervise-banks/our-policy-work-for-bank-oversight/2025-review-of-key-capital-settings>.

¹¹⁴ For the most up to date information about the DTA timeline, see Reserve Bank of New Zealand. (2025). *DTA timeline*. <https://www.rbnz.govt.nz/regulation-and-supervision/deposit-takers-act/dta-timeline>.

Annex A: Glossary

Additional Tier 1 (AT1) capital	The second highest quality of capital behind Common Equity Tier 1. Under current Reserve Bank policies, Additional Tier 1 capital is made up of perpetual preference shares that offer fixed dividends, no redemption date and which limit other rights of the holder. Preference shares rank ahead of ordinary shares in a liquidation.
Asset correlation (R)	An input in internal ratings-based models for calculating risk-weighted assets that represents how strongly linked defaults in a credit portfolio are to general economic conditions, as opposed to idiosyncratic factors.
Australian Prudential Regulation Authority (APRA)	An independent statutory authority responsible for the prudential supervision of financial institutions in Australia.
Bail-in	A crisis management strategy that seeks to recapitalise a deposit taker that is likely to fail (or has failed) by writing down, or converting into ordinary shares, selected capital instruments and liabilities. There are different ways bail-in can be effected using different legal mechanisms.
Banking Industry Country Risk Assessment (BICRA)	A methodology used by S&P Global Ratings to evaluate the strength of banking systems around the world. It scores banking systems on economic risk and industry risk. Banking Industry Country Risk Assessment reports are typically updated monthly.
Basel (Basel I, II, III) framework	A set of standards developed by the Basel Committee on Banking Supervision, which is the primary global standard setter for the prudential regulation of banks. The most recent of these frameworks is Basel III, introduced in December 2010.
Capital Asset Pricing Model (CAPM)	A model showing that the expected return on an asset is equal to the risk-free rate plus a risk premium. The risk premium of an asset depends on the volatility of its returns relative to the market. Assets with more volatile returns are riskier, so have a higher risk premium and higher expected returns.
Capital buffer (or 'prudential capital buffer' or 'CET1 buffer')	Absorbs losses during stress and protects deposit takers from breaching their minimum capital requirements. The capital buffer must be made up of entirely Common Equity Tier 1 capital. The capital buffer can be made up of a number of components (see

	definitions below): a Conservation buffer, Domestic Systemically Important Banks Capital buffer and Counter-Cyclical Capital buffer.
Capital ratio	A deposit taker's capital divided by its risk-weighted assets (see definition below). A capital ratio is a key indicator of the financial strength of a deposit taker, measuring the losses it can withstand relative to the risk of the deposit taker's business.
Capital Requirements (or 'Prudential Capital Requirements')	The minimum investment in a deposit taker that must be funded through the issuance of capital instruments (e.g. Common Equity Tier 1, Additional Tier 1, Tier 2 and Loss-Absorbing Capacity) and amount of capital that the Reserve Bank requires deposit takers to have. It includes minimum capital requirements, prudential capital buffers and requirements regarding the approach to risk weights.
Capital Review decisions in 2019	These decisions introduced higher capital requirements for registered banks under the Bank (Prudential Supervision) Act 1989 which are split into two broad categories: minimum capital requirements (see definition below) and capital requirements (see definition above). The combined impact of these is in the process of gradually shifting up to 18% of risk-weighted assets (see definition below) for the four largest banks. An outcome of the review in 2019 was to no longer recognise convertible debt securities for capital purposes.
Capital stack	The full set of capital instruments for a deposit taker. It includes Tier 1 and Tier 2 capital instruments (see definitions below).
Capital Standard	One of the standards that banks and non-bank deposit takers will be licensed against under the Deposit Takers Act 2023. This will replace existing prudential requirements to form new capital rules for deposit takers. Decisions from the 2025 Review of key capital settings will be incorporated into the Capital Standard.
Common Equity Tier 1 (CET1) capital	The highest quality of capital as it is permanently available to absorb a deposit taker's financial losses. Common Equity Tier 1 capital includes shareholders' investment (ordinary shares) and the deposit taker's retained earnings.
Community Housing Providers (CHPs)	Generally not-for-profit groups that meet housing needs through a range of affordable rental and home ownership options.

Conservation buffer	A type of prudential capital buffer that applies to all deposit takers. The conservation buffer promotes capital resilience by requiring deposit takers to maintain capital levels above their minimum capital requirements.
Cost benefit analysis (CBA)	This involves estimating, where possible, the monetary value of all the costs and benefits of a decision to determine an expected net impact of the decision. A Cost Benefit Analysis is one tool that the Reserve Bank uses to compare different policy options.
Counter-Cyclical Capital Buffer (CCyB)	A type of prudential capital buffer that the Reserve Bank may increase or decrease over the financial cycle. Increasing the Counter-Cyclical Capital Buffer aims to build deposit takers' capital resilience and guard against financial stability risks. Lowering the Counter-Cyclical Capital Buffer enables deposit takers to operate at lower capital levels during periods of financial system stress, to promote their ability to continue lending to support the economy.
Credit Contracts and Consumer Finance Act 2003 (CCCFA)	This sets the legislative framework for credit contracts, consumer leases and buy-back transactions of land. Its primary purpose is to protect the interests of consumers in connection with these activities.
Crisis event	For the purposes of the Cost Benefit Analysis (see definition below), this means an event where all deposit takers' capital is absorbed by losses.
Crisis management	This refers to the responses of the Reserve Bank, deposit takers and other relevant stakeholders to manage the impact of financial distress when it arises. This is both when there is the potential for recovery, and when a deposit taker is likely to fail (or has failed).
Crisis management framework	This includes the powers, regulations, policies, tools, strategies and processes in place that inform and enable the Reserve Bank and deposit takers' actions in response to financial distress and potential failure. It also includes business-as-usual preparations and the governance and testing of these arrangements, to ensure they operate effectively in practice.
Debt-to-income (DTI)	This measures the amount of debt a borrower has, relative to their gross income. Debt-to-income restrictions are a macroprudential tool used by the Reserve Bank to limit the

	portion of banks' new lending towards home loans that exceed debt-to-income thresholds. Debt-to-income restrictions aim to reduce the probability of default.
Default rate	The cumulative defaulted exposures over a given time period as a proportion of the opening exposures.
Deposit taker	An entity that meets the definition of deposit taker in clause 2 of Schedule 2 of the Deposit Takers Act 2023.
Depositor Compensation Scheme (DCS)	The Depositor Compensation Scheme is a deposit compensation scheme funded by deposit takers and administered by the Reserve Bank. It covers each eligible depositor up to \$100,000 per deposit taker in the event of a failure, when money is held in DCS-protected accounts.
Deposit Takers Act 2023 (DTA)	Legislation that provides for the prudential regulation of deposit takers. From 2028 it is intended that the Deposit Takers Act 2023 will replace the Banking (Prudential Supervision) Act 1989 and the Non-bank Deposit Takers Act 2013.
Domestic Systemically Important Banks (D-SIBs)	Banks whose failure would result in significant disruption to the New Zealand financial system and economy due to their size, interconnectedness, lack of substitutability, and complexity. ANZ, ASB, BNZ, and Westpac are currently identified as Domestic Systemically Important Banks.
Domestic Systemically Important Bank Capital buffer (D-SIB buffer)	A type of prudential capital buffer that applies to deposit takers that are identified as Domestic Systemically Important Banks. A Domestic Systemically Important Bank Capital buffer promotes higher capital strength of deposit takers and lowers their probability of failure.
Exchange Settlement Account System (ESAS)	New Zealand's real time gross settlement payments system. The Exchange Settlement Account System allows transactions between financial institutions to be settled electronically as the transactions happen. The system is owned and operated by the Reserve Bank.
Exposure at default (EAD)	The expected notional value of a credit exposure at the point of default.

Finance and Expenditure Committee (FEC)	A select committee of the New Zealand parliament. The business that the committee looks at includes economic and fiscal policy, taxation, revenue, and banking and finance. In June 2024, a Select Committee inquiry commenced on banking competition, which also focused on rural banking.
Financial Policy Remit (FPR)	Specifies or provides for matters that the Minister of Finance considers are desirable for the Reserve Bank to have regard to in relation to our financial stability objective, the objectives or purposes of our prudential regulation, and acting as a prudential regulator and supervisor. The Financial Policy Remit is issued by the Minister of Finance under the Reserve Bank of New Zealand Act 2021.
Financial Stability Report (FSR)	The Reserve Bank's assessment of risks to the New Zealand financial system. We publish the Financial Stability Report every six months.
Global Financial Crisis (GFC)	The period of extreme stress in global financial markets and banking systems between 2007 and 2009.
Going concern capital	Instruments that absorb losses while the deposit taker remains an economically viable entity. These instruments help maintain ongoing operations and market confidence.
Gone concern capital	Instruments that absorb losses once the deposit taker is no longer economically viable. This includes a regulator led bail-in using crisis management powers, as without that intervention the deposit taker could not have continued operating or sustained market confidence.
Gross Domestic Product (GDP)	A way of measuring economic activity and income in a country in a given period of time. Gross Domestic Product is all the consumption, investment, government spending, and net exports (exports less imports) in an economy. Changes in Gross Domestic Product are New Zealand's official measure of economic growth.
Group 1, 2 and 3 deposit takers	Categories of deposit takers that are set out in the Proportionality Framework. Group 1 includes deposit takers with total assets NZ\$100 billion or more. Group 2 deposit takers have total assets of NZ\$2 billion or more, but less than NZ\$100 billion. Group 3 have total assets of less than NZ\$2 billion. We allocate deposit takers into groups to support the consistent application of

	requirements to similar deposit takers, and to allow for requirements to be set proportionately for each group.
Internal ratings-based (IRB) approach	Allows accredited deposit takers to use the internal models-based approach to calculate their risk weights for credit risk; otherwise, they must use the standardised approach. Accredited deposit takers are sometimes called 'Internal ratings-based banks' or 'IRB banks'. Risk weights for other types of exposures, including operational risk and market risk, must be calculated using the standardised approach.
Lenders Mortgage Insurance (LMI)	Protects a lender from incurring losses in the event that a borrower defaults on a home loan.
Loan-to-value ratio (LVR)	A measure of how much a bank lends against mortgaged property, compared to the value of that property. Loan-to-value ratios are used in credit risk weights for some exposures, including residential mortgage loans, in the standardised approach to credit risk. Separately, loan-to-value ratio restrictions are a macroprudential tool used by the Reserve Bank to limit how much new high loan-to-value ratio lending banks can make. We vary these restrictions in response to changing financial system risks. Tighter loan-to-value ratio restrictions help to reduce the number of highly leveraged borrowers and lower loss given default, supporting the stability of the housing market and reducing the risk of a sharp correction in house prices.
Loss-Absorbing Capacity (LAC) instruments	Debt instruments that make up part of a deposit taker's funding and are pre-positioned to allow for bail-in. A Loss-Absorbing Capacity requirement would be in addition to the minimum capital requirements and capital buffers. LAC can be issued to other members of a deposit taker's group (internal Loss-Absorbing Capacity) or to other parties (external Loss-Absorbing Capacity).
Loss given default (LGD)	The proportion of exposure at default that is expected to be lost following default, calibrated to economic downturn conditions.
Loss rate	The cumulative impairment expense over a given time period as a proportion of the opening exposure.
Minimum capital (ratio) requirements	The minimum capital ratio must be met in order to be licensed and operate as a deposit taker. If a deposit taker has a capital

	ratio below the minimum requirement, it is likely to be in financial distress from a prudential perspective.
Modigliani-Miller (MM) theorem	States that changes in a firm's funding structure (i.e. the ratio of equity finance to debt finance) would have no impact on its weighted average cost of capital. Increases in profitability through the greater use of leverage when capital is lower will be offset by a higher unit cost for the remaining equity capital, since that equity becomes relatively riskier. Therefore, in the context of banks, if the Modigliani-Miller theorem holds fully, changes in capital requirements should have no effect on the cost of lending.
Non-bank deposit taker (NBDT)	An entity that meets the definition of non-bank deposit taker in section 5 of the Non-bank Deposit Takers Act 2013.
Non-bank Deposit Takers Act 2013 (NBDT Act)	Legislation that provides for the Prudential regulation of non-bank deposit takers. It is intended that the Non-bank Deposit Takers Act 2013 will be replaced by Deposit Takers Act 2023 from 2028.
Output floor	A limit on the internal ratings-based (see definition above) approach for deposit takers that calculate the credit risk weighted assets (see definition above) using the internal ratings-based approach. When determining its capital ratio, the risk weighted assets for credit risk cannot go below 85% of the risk weighted assets that the deposit taker would calculate under the standardised approach (see definition below).
Pillars 1, 2, and 3	Components of the Basel framework (see definition above). Pillar 1 requirements are minimum capital requirements to cover credit risk, market risk and operational risk. Pillar 2 includes additional capital requirements for other risks identified as part of the supervisory review process. Pillar 3 covers disclosure requirements and is designed to enforce market discipline on banks.
Probability of default (PD)	The likelihood that a credit exposure will default, averaged over a range of economic conditions. It is expressed as an annual rate.
Proportionality framework	Sets out how the Reserve Bank takes into account the proportionality principle when developing standards for deposit takers licensed under the DTA. See <i>Group 1, 2 and 3 deposit takers</i> defined above.

Regulatory Impact Assessment (RIAs)	An analysis of the likely impact of proposed regulatory changes.
Recapitalise	The process of restoring a deposit taker's capital to an adequate level by generating new capital from external sources or bail-in.
Residential mortgage lending (RML)	Defined in section C3.2 of BPR131: Standardised credit RWAs. It is a loan secured by a first ranking mortgage over a residential property used primarily for residential purposes by the mortgagor, a related party of the mortgagor, or a tenant of the mortgagor
Risk weighted assets (RWA)	An adjusted picture of a deposit taker's financial position (for example, its loan portfolios and other investments, and its operational and market trading activities) that takes into account the risk profile of that financial position.
Scalar	A scaling factor that must be applied to risk-weighted assets for credit risk calculated using the internal ratings-based approach. A New Zealand deposit taker must multiply its risk weighted assets for credit risk calculated using the internal ratings-based approach by 1.2 when determining its capital ratio.
Sensitivity analysis	Shows the impact of changing one variable in a model at a time, or changing a small set of closely related variables, while holding everything else constant. Sensitivity analysis shows how different model calibrations affect the conclusions that can be drawn when there is some uncertainty around the model parameters.
Single point of entry (SPE)	A model of recovery or resolution where the group the deposit taker is part of is kept together. For example, under our preferred single point of entry model, the Australian parent entity would transfer or 'downstream' sufficient capital to the New Zealand subsidiary to restore its viability in a crisis.
Small and medium-sized enterprise (SME)	In the internal ratings-based approach, banks may separately address exposures to small and medium-sized enterprises in a separate retail small and medium-sized enterprise sub-category of exposures. A loan that is extended to a small business and managed as a retail exposure, and that does not qualify as residential mortgage lending, is eligible for retail treatment where the banking group's total business-related exposure to the borrowing enterprise (on a consolidated basis, where applicable) is less than NZ\$1 million.

Standardised approach to credit risk	One of the two methodologies available to calculate risk weighted assets for deposit takers' credit risks. The standardised approach requires deposit takers to use Reserve Bank specified rules to determine the risk weights to apply to different types of loans and other assets.
Statement of Approach to Resolution (SoAR)	A document that will be issued under the Deposit Takers Act 2023 setting out the Reserve Bank's expected resolution strategies and intended approach to co-operating with relevant stakeholders when performing or exercising its functions powers or duties under the crisis management provisions of the Deposit Takers Act 2023. The Deposit Takers Act 2023 requires the Reserve Bank to publish this statement and regularly review it. The first Statement of Approach to Resolution is expected to be published by mid-2029.
Summary of Submissions and Policy Decisions for the Capital Standard ('Response Document')	This document outlines our responses to the consultation feedback on the Capital Standard received in relation to the Deposit Takers Core Standards consultation paper published on 16 May 2024. The Response Document has been released alongside this document.
Swiss Financial Market Supervisory Authority (FINMA)	The independent financial markets regulator in Switzerland.
Terms of reference	The 2025 Review of key capital settings sets out the purpose, approach, scope and timing of the review. See <u>2025 Review of key capital settings - Reserve Bank of New Zealand - Te Pūtea Matua</u> .
Tier 1 capital	Is made up of a combination of Common Equity Tier 1 capital and Additional Tier 1 capital. See definitions of these types of capital above.
Tier 2 capital	Comprises certain types of reserves and subordinated debt instruments that do not qualify as Common Equity Tier 1 capital or Additional Tier 1 capital, but are available to absorb losses ahead of more senior creditors of the banking group in a winding up.
Total capital ratio (TCR)	Defined in BPR100: Capital Adequacy. Measured as total capital divided by total risk weighted assets.

Total Loss-Absorbing Capacity (TLAC)	An international regulatory standard requiring global systemically important banks to have sufficient equity and bail-in debt that can absorb losses and recapitalise the deposit taker during a crisis, minimising the application of government funds.
Weighted Average Funding Cost (WAFC)	A deposit taker's average funding cost across all funding sources.
Whenua Māori	Māori freehold land.

Annex B: Consolidated consultation questions

Chapter 1: Introduction

- Q1** Do you have any comments on the proposed assessment criteria?
- Q2** Do you have any comments on the appropriate risk appetite for New Zealand's capital settings?

Chapter 2: Context

- Q3** Do you have any feedback on our assessment of the impacts of legislative and policy changes since 2019?
- Q4** Do you have any feedback on our assessment of the new evidence since 2019?
- Q5** Is there other new evidence not discussed in this section that we should be considering?
- Q6** Do you have any feedback on this analysis of how New Zealand deposit takers' current and planned capital levels compare to other jurisdictions?

Chapter 3: Capital stack options

- Q7** Do you have any feedback on the two high-level options for Group 1?
- Q8** Do you have any alternative proposals?
- Q9** Do you have any feedback on the proposal for Group 2?
- Q10** Do you have any alternative proposals?
- Q11** Do you have any feedback on the proposal for Group 3?
- Q12** Do you have any alternative proposals?
- Q13** Do you agree with the proposal of a 1% Counter-Cyclical Capital Buffer for Group 1 and 2 deposit takers under the options proposed?

- Q14** Do you agree with the proposal that the Counter-Cyclical Capital Buffer should not apply to Group 3 deposit takers?
- Q15** Do you have any feedback on our analysis of the proposed options against the criteria?
- Q16** Do you think it would be preferable from a crisis management perspective to maintain a higher Prudential Capital Buffer or have a lower Prudential Capital Buffer and Loss-Absorbing Capacity for Group 1?
- Q17** If you consider that one option is preferable, what are the reasons why?
- Q18** Do you have any feedback on the degree of proportionality across the proposed options and capital stacks?
- Q19** Do you have any feedback on the implications for competition from our proposed options?
- Q20** Do you have any feedback on our analysis of the options against the assessment criteria?
- Q21** Do you have any feedback on our approach to the cost benefit analysis?
- Q22** Do you have any feedback about the results of the cost benefit analysis?
- Q23** Do you have any additional evidence that should be considered in the cost benefit analysis?
- Q24** Do you have any comments about the way that Loss-Absorbing Capacity has been incorporated into the approach?

Chapter 4: Additional Tier 1

- Q25** Do you agree with the proposal to remove Additional Tier 1 capital as a form of regulatory capital?
- Q26** Are there any other factors that you think we should take into account in making this decision?

Q27 Do you have any views on the most appropriate transitional arrangements, including how Additional Tier 1 capital instruments should be recognised after any possible removal?

Q28 Are there any additional factors that should be taken into account for Group 3 deposit takers?

Chapter 5: Standardised risk weights

Q29 Do you agree that the Reserve Bank should introduce more granular standardised risk weights for mortgage, corporate and agricultural lending?

Q30 Do you have any comments on the proposed changes to standardised risk weights for mortgage, corporate and agricultural lending?

Q31 For deposit takers: Can you quantify the overall and sectoral impact that the proposed changes to standardised risk weights for residential mortgage, corporate, and agricultural lending would have on your institution?

Q32 Would you expect more granular residential mortgage lending risk weights to lead to more differentiation in loan pricing to borrowers?

Q33 For deposit takers: Can you provide a lending breakdown for your institution by the following corporate sectors: rating, small and medium-sized enterprise retail, small and medium-sized enterprise corporate, and other unrated corporate?

Q34 Do you agree with creating a new standardised risk weight category for all unrated corporate commercial property lending?

Q35 For deposit takers: Can you quantify the impact that a 100% risk weight under the standardised approach on all unrated commercial property lending would have on your institution?

Q36 Do you have any comments on increasing risk weights for personal lending?

Q37 For deposit takers: Can you quantify the impact that a 100% risk weight on secured personal lending and a 150% risk weight on unsecured personal lending would have on your institution?

Q38 For deposit takers: Can you provide a lending breakdown for your institution for the following sectors: commercial property (investment, development, and a

loan-to-value ratio breakdown within these categories), and personal lending (secured, unsecured, credit card and other)?

- Q39** Do you think the proposed standardised risk weights more closely align with the actual risk of the underlying lending? If not, where do you think the biggest discrepancies are?
- Q40** For deposit takers: Is there a desired lead-in time to adopt the proposed standardised risk weight categories and updated minimum capital ratio? What are the expected costs (and their magnitude) to systems and processes of the proposed standardised risk weight categories?
- Q41** Is there anything else you think we should consider when contemplating changes to standardised risk weights or analysing their impacts?
- Q42** Do you think the proposed approach to standardised risk weights aligns with the main purpose of the Deposit Takers Act 2023 (section 3(1)) and the additional purposes (section 3(2))?¹¹⁵
- Q43** Do you agree with the proposed approach for risk weights on lending for Community Housing Providers and housing co-operatives? Will this approach accurately reflect the risk of that lending?
- Q44** Do you think the proposed approach for risk weights on lending for Community Housing Providers and housing co-operatives aligns with the main purpose of the Deposit Takers Act 2023 (section 3(1)) and the additional purposes (section 3(2))?¹¹⁶
- Q45** How has the Māori Land Court whenua Māori practice note altered borrowing and lending decisions?
- Q46** For deposit takers: How do you treat lending where whenua Māori is the security? Does this affect your assessment of risk?
- Q47** Does lending secured by whenua Māori have different risk characteristics than other lending, and if so, how should this be incorporated into prudential requirements? Is this relevant for residential mortgage lending, and/or other forms of lending?
- Q48** Will lending secured by whenua Māori benefit from the other changes proposed in this Review?

¹¹⁵ Deposit Takers Act 2023, s 3. <https://legislation.govt.nz/act/public/2023/0035/latest/LMS469449.html>.

¹¹⁶ Deposit Takers Act 2023, s 3. <https://legislation.govt.nz/act/public/2023/0035/latest/LMS469449.html>

- Q49** Are there other aspects of the prudential framework that could be addressed to more accurately align risk weights with actual risk for lending secured by whenua Māori?
- Q50** What are the barriers to borrowing/lending when whenua Māori is used as security?
- Q51** For deposit takers: Do you participate in the whenua Māori Lenders Mortgage Insurance underwriting programme run by Kāinga Ora?
- Q52** Do you support excluding lending for property development from the proposed approach to risk weights for lending to Community Housing Providers and housing co-operatives?
- Q53** Are the risks during the property development and construction phase different from providing accommodation in finished dwellings?
- Q54** Do you support excluding lending to third-party providers (who intend to lease to Community Housing Providers or housing co-operatives) from the proposed approach to risk weights for lending to Community Housing Providers and housing co-operatives?
- Q55** Are the risks of lending by third-party borrowers different from lending directly to Community Housing Providers?

Annex C: DTA purposes and principles

This annex sets out the purposes of the Deposit Takers Act 2023 (**DTA**) and principles the Reserve Bank is required to have regard to when exercising functions, powers, and duties under the Act.

The main purpose of the DTA is to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system.

To that end, the DTA also has the following additional purposes:

- Soundness – to promote the safety and soundness of each deposit taker (section 3(2)(a));
- Public confidence – to promote public confidence in the financial system (section 3(2)(b));
- Accessibility – to the extent not inconsistent with the main purpose or the other additional purposes, to support New Zealanders having reasonable access to financial products and services (section 3(2)(c));
- Avoidance or mitigation of risks – to avoid or mitigate the adverse effect of risks:
 - to the stability of the financial system;
 - from the financial system that may damage the broader economy (section 3(2)(d)).

In issuing standards under the DTA, as well as identifying the purpose or purposes for which we are acting, we must take into account certain principles (where they are relevant to the performance or exercise of our powers under the DTA). These principles are:

- the desirability of taking a proportionate approach to regulation and supervision (section 4 (a)(i));
- the desirability of consistency in the treatment of similar institutions (section 4 (a)(ii));
- the desirability of the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders (section 4 (a)(iii));
- the need to maintain competition within the deposit-taking sector (section 4(b));
- the need to avoid unnecessary compliance costs (section 4(c));
- the desirability of maintaining awareness of, and responding to, the practices of overseas supervisors that perform functions in relation to any licensed deposit taker or any holding company of any licensed deposit taker; and guidance or standards of international organisations (section 4(d)(i) and (ii));
- the desirability of ensuring that the risks referred to in section 3(2)(d) are managed (including long-term risks to the stability of the financial system) (section 4(e));
- the desirability of sound governance of deposit takers (section 4(f));

- the desirability of deposit takers effectively managing their capital, liquidity, and risk (section 4(g)); and
- the desirability of depositors having access to timely, accurate, and understandable information to assist them to make decisions relating to debt securities issued by deposit takers (section 4(h)).

The DTA also provides the following statutory purposes for crisis management and resolution (section 259) in addition to the purposes above:

- a. to avoid significant damage to the financial system that could result from a licensed deposit taker being in financial distress or other difficulties, including—
 - i. by maintaining the continuity of systemically important activities undertaken by licensed deposit takers in New Zealand; and
 - ii. by mitigating, or otherwise managing, any loss of confidence in the financial system resulting from a licensed deposit taker being in financial distress or other difficulties; and
- b. to enable a licensed deposit taker that is in resolution to be dealt with in an orderly manner; and
- c. to support the purpose of Part 6 (which deals with the establishment and operation of the Depositor Compensation Scheme); and
- d. to the extent not inconsistent with any of paragraphs (a), (b), and (c), to minimise the costs of dealing with, or costs or losses otherwise incurred in connection with, a licensed deposit taker that is in financial distress or other difficulties by—
 - i. preserving the interests of creditors and maintaining the ranking of claims of creditors; and
 - ii. dealing with the financial distress or other difficulties as quickly as is reasonably practicable; and
- e. to the extent not inconsistent with any of paragraphs (a), (b), and (c), to support the effective and efficient management of public financial resources by avoiding or minimising, and otherwise managing, the need to rely on public money to deal with a licensed deposit taker that is in financial distress or other difficulties.

Annex D: Assessment of changes in the macroeconomic risk environment

As set out in Section 2.2, we have considered how risks in the macroeconomic environment have changed since our previous review in 2019. Table 24 below provides more details of our assessment.

Table 24: Changes in risk to the macroeconomic environment since 2019

Variable/Risk	Assessment
Geopolitics / conflict	Geopolitical risks have increased since 2019 , driven by heightened tensions among the major powers, the erosion of international norms and institutions, and a growing incidence of conflict, including in Ukraine and the Middle East. ¹¹⁷ This trend is reflected in sentiment indicators, such as the Bank of England's Systemic Risk Survey. ¹¹⁸ As a small, open economy heavily reliant on maritime trade, overseas funding, and migration, New Zealand is particularly exposed to the implications of rising geopolitical risk.
Trade policy	Risks from trade tensions have risen , driven partly by geopolitical tensions, protectionist sentiment, and large bilateral trade deficits between some economies. International trade frameworks have been undermined over time, as major economies increasingly rely on unilateral actions to address perceived imbalances. This has resulted in sweeping United States tariff announcements in early 2025, and retaliatory measures by China and other countries. ¹¹⁹ New Zealand is exposed to trade policy shocks as we depend on external demand from all major trading economies. In general, we consider both the direct impact of trade restrictions on our exports and the indirect impact from lower growth in other trading partners, and these indirect impacts are often more important.
COVID-19 / black swan events	We have increased our understanding of tail risks through the COVID-19 experience and regulatory stress tests, including for global pandemic risks and for the insurance sector. In hindsight, the underlying tail risk distribution appears more negative than we had considered in 2019. However, should another pandemic or other tail risk event occur, we should be better prepared to respond owing to the recent experience. We are now more cognisant of how these shocks may interact with other variables such as fiscal policy, social cohesion, and geopolitical tension. ¹²⁰
Climate risk	Climate risks have continued to increase since 2019 . Rising physical risk is evidenced by the escalating cost of natural disasters, record global emissions, and deterioration of natural assets that are vital for tourism in New Zealand. Transition risks remain high, with some states and corporations retreating from climate-related commitments. Increases in insurance and reinsurance costs owing to climate-related weather events also contribute to debt-servicing burden. However, we have

117 See Box A in Reserve Bank of New Zealand. (2024). *Financial Stability Report: November 2024*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/financial-stability-reports/2024/nov-2024/fsr-nov-2024.pdf>.

118 Bank of England. (2025). *Systemic Risk Survey Results – 2025 H1*. <https://www.bankofengland.co.uk/systemic-risk-survey/2025/2025-h1>

119 For more detail see Reserve Bank of New Zealand. (2025). *Financial Stability Report: May 2025*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/financial-stability-reports/2025/may/financial-stability-report-may-2025.pdf>.

120 Bloor, C., Knowles, J., & Nicholls, K. (2020). Outcomes from a COVID-19 stress test of New Zealand banks. *Reserve Bank of New Zealand Bulletin*, 83(3). <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/bulletins/2020/rbb2020-83-03.pdf>

Variable/Risk	Assessment
	significantly increased our understanding of climate risks, including through a climate stress test for banks. ¹²¹
Financial asset valuations	Concerns persist about financial asset valuations. Previous low interest rates, upbeat economic performance and increased private credit in the United States have led to strong growth in equity prices. However, structural concerns around global growth have raised questions around the extent of asset price overvaluation, relative to underlying economic fundamentals. Moreover, fiscal sustainability risks in the major economies have the potential to trigger market turbulence, undermine investor confidence and raise risk premiums. These fiscal concerns appear more pressing relative to 2019, particularly in the United States.
Domestic macroeconomic risks	Housing market risks appear to have eased on a through-the-cycle basis. Cyclically, housing demand remains subdued following a period of high interest rates and low migration, restraining housing credit growth at present. However, there are also structural factors limiting the risks of a house price correction. Government policy changes since 2019 have aimed to increase residential land supply, allow for greater densification, and improve infrastructure provision. If successful, greater supply responsiveness to price changes would moderate the extremes in future house price cycles. Agriculture sector risks have edged upwards on a long-term basis. In the short term, agriculture sector conditions have improved owing to high dairy and beef prices and declining interest rates. However, through-the-cycle risks have increased owing to heightened geopolitical tension, trade policy uncertainty and geoeconomic fragmentation. Trade concentration risks remain around the reliance on China as our largest export market. These risks reflect the sensitivity of the agriculture sector to external demand.

¹²¹ For more detail, see Adams-Kane, J., Nicholls, K., & West, T. (2023). 2023 Climate stress test results. *Reserve Bank of New Zealand Bulletin*, 87(5). <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/bulletins/2024/rbb-2024-87-05.pdf>, and Box C in Reserve Bank of New Zealand. (2022). *Financial Stability Report: November 2022*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/financial-stability-reports/2022/nov-2022/fsr-nov-22.pdf>.

Annex E: Cost benefit analysis

This annex provides more details on our cost benefit analysis (**CBA**) of the options presented in Section 3.6. The CBA seeks to quantify the impacts capital has on financial stability and expected output from interest rate changes. As in 2019, the models used in estimating the costs and benefits of each option are highly stylised and are dependent on a relatively small number of inputs. Nevertheless, similar models are widely used globally,¹²² and provide a helpful piece of the puzzle when evaluating each option. The CBA should be read alongside (rather than instead of) the qualitative analysis provided throughout this Consultation Paper.

Table 25 summarises our central estimates relative to the status quo of the policy decisions made following the 2019 Capital Review being fully in force in 2028.

Table 25: Central estimates of cost benefit analysis

High-level impact		Option 1. Consultation (no LAC)	Option 2. Consultation (LAC)
Indirect impact: Expected gross domestic product (GDP)	Output gain from lower lending rates (%)	0.08	0.14
	Output loss from bank failures (%)	-0.24	-0.06
	Net expected GDP benefit (%)	-0.16	0.08
Direct impact: Transfer of wealth	Direct savings from lower interest payments (to overseas owners) (%)	0.09	0.16
	Lower tax on interest payments (%)	-0.03	-0.04
	Net wealth transfer cost (%)	0.07	0.11
Total net benefit in comparison to 2019 Capital Review decisions (annual level of GDP) (%)		-0.09	0.20

Table 26 summarises our sensitivity analysis. The base case shown above provides a fair and credible estimate of the costs and benefits. However, we have analysed several different sensitivities, which focus both on the expected interest rate changes (Sensitivity 1 and 2) and the cost of failures on New Zealand (Sensitivity 3 and 4). The status quo (2019 Capital decisions) estimates are also adjusted to take into account the scenario settings. More details of these sensitivity assumptions are discussed below.

¹²² Basel Committee on Banking Supervision. (2021). *Assessing the impact of Basel III: Evidence from macroeconomic models: literature review and simulations*. <https://www.bis.org/bcbss/publ/wp38.pdf>

Table 26: Sensitivity analysis of costs and benefits

Sensitivity		Option 1. Consultation (no LAC)	Option 2. Consultation (LAC)
Sensitivity 1: "No MM" Investors do not require a higher rate of return if capital is reduced.	Output gain from fall in lending rates (%)	0.10	0.17
	Output loss from financial crisis (%)	-0.24	-0.06
	Change in net wealth transfers (%)	0.08	0.14
	Net benefit (%)	-0.05	0.26
Sensitivity 2: "Double MM" Investors require double the change in rate of return, as assumed in the base scenario	Output gain from fall in lending rates (%)	0.06	0.11
	Output loss from financial crisis (%)	-0.24	-0.06
	Change in net wealth transfers (%)	0.05	0.09
	Net benefit (%)	-0.13	0.14
Sensitivity 3: Cost of LAC event (15% GDP) Lower the assumed cost of a LAC event on the NZ economy from 20% to 15%	Output gain from fall in lending rates (%)	0.08	0.14
	Output loss from financial crisis (%)	-0.24	-0.01
	Change in net wealth transfers (%)	0.07	0.11
	Net benefit (%)	-0.09	0.25
Sensitivity 4: Cost of crisis event (50% GDP) Lower the assumed cost of a crisis on the NZ economy from 63% to 50%	Output gain from fall in lending rates (%)	0.08	0.14
	Output loss from financial crisis (%)	-0.19	-0.09
	Change in net wealth transfers (%)	0.07	0.11
	Net benefit (%)	-0.04	0.17

Background

We have used the same underlying approach to CBA as in the 2019 Capital Review. Specific parts of the model are improved by updating input data and using more objective market data, where possible. In addition, to provide improved comparability between options we seek to measure the costs and benefits of additional Loss-Absorbing Capacity (**LAC**) (as compared to Common Equity Tier 1 (**CET1**) Capital). The model also includes how changes to Group 2 requirements are likely to affect overall financial stability.

The CBA can be split into two broad impacts - an output impact and a direct impact. The output impact estimates the benefits of lower capital on long term output in the economy from lower lending rates (lending rate impact), as well as the estimated cost to New Zealand of the risk of a banking crisis (cost of crisis impact). Analysis of lending rates and costs of crises is common internationally and we rely on credible international studies for our assumptions.¹²³

The direct impact is the cost to New Zealand of the transfer of funds from New Zealand borrowers, through the deposit taker, and ultimately to their overseas owners. Returns to equity holders are taxable, which means that any reductions in payments would see a lower amount of tax collected on payments to overseas owners.

Lower capital requirements should reduce interest rates in the economy, but increase the risk of bank failures

The central problem for deposit takers and prudential regulators is that capital is the best instrument to mitigate the risk of bank failures, but that high capital can lead to higher lending costs for businesses and individuals, and lower deposit returns for depositors. That is, there is always a trade-off in higher or lower capital amounts.

Many factors can make quantifying this trade-off difficult. For example, having additional capital can lead to added costs on deposit takers, and these costs are passed on to borrowers and depositors. The degree to which higher capital can increase average funding costs is subject to debate. In addition, assumptions around how these costs are passed on can also be difficult to estimate.

The approach used attempts to measure the costs and benefits of capital through its impacts on potential GDP.

Part 1: Lending rate benefits

Capital, especially CET1 capital, reduces the likelihood of bank failures. However, deposit takers incur higher funding costs as they have more capital, in turn leading to higher lending rates, lower returns for depositors, and overall lower economy activity.

We estimate the change in weighted average funding costs (**WAFC**) for deposit takers based on the model adopted in the 2019 Capital Review.¹²⁴ The 2019 model has been updated to use recent

¹²³ Basel Committee on Banking Supervision. (2010). *As assessment of the long-term economic impact of stronger capital and liquidity requirements*. <https://www.bis.org/publ/bcb173.pdf>

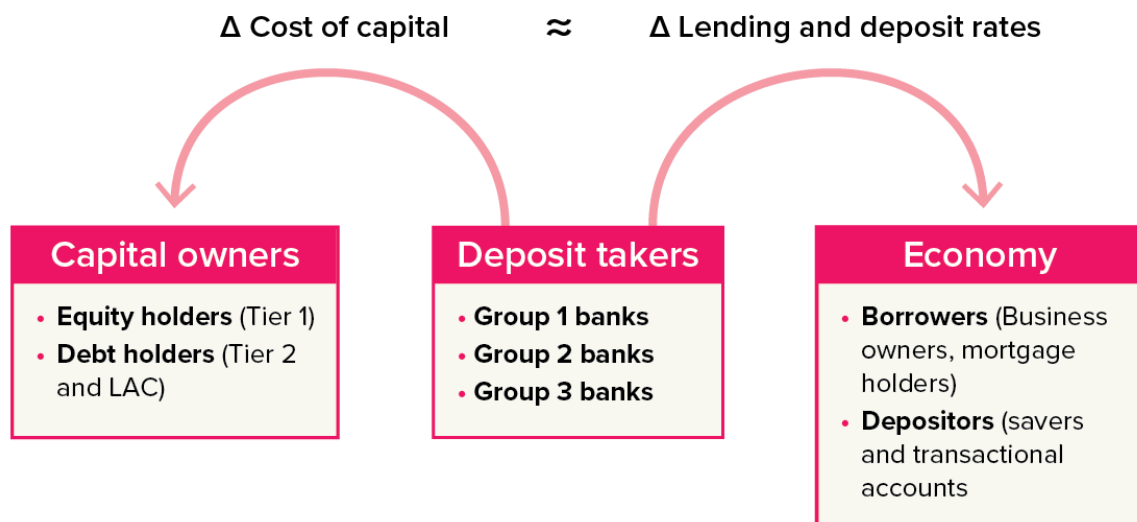
¹²⁴ Reserve Bank of New Zealand. (2019). *Capital Review Regulatory Impact Assessment and Cost-Benefit Analysis 2019*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/decisions/capital-review-cost-benefit-analysis.pdf>

market information, considering previous feedback. In addition, we include estimates of the cost of LAC.

For each option we have estimated the impact that the change in banks' capital structures would have on their WAFC. We compare the different options with a counterfactual, under which banks would continue to increase their capital levels in line with the original 2019 Capital Review decisions, and with no changes to risk weights.

The 2019 cost of capital model is based on the premise that owners of deposit takers' capital – shareholders and debt holders – require a return, usually in the form of dividends and interest. If a deposit taker has to pay more (or less) to these capital owners, it is expected they will pass these costs on to its borrowers through higher lending rates. Higher interest rates in the economy reduce economic activity by disincentivising New Zealanders from purchases and investments.

Figure 24: Transmission of costs of capital to New Zealanders



Both the capital mix and the total amount of capital play an important role in the total cost of capital incurred by deposit takers.

Capital mix

The current regulatory capital requirements are made up of different types of capital. The average return on these instruments that deposit takers have to pay the owners contributes to the deposit takers 'cost of capital'.

Currently total capital is made up of a mix of:

- CET1 capital
- Additional Tier 1 (AT1) capital
- Subordinated debt capital (Tier 2)

As outlined, we are now also considering the costs and benefits of introducing a fourth instrument:

- LAC instruments.

For deposit takers, equity capital (CET1 and AT1) is more expensive than Tier 2 capital. This is because equity capital is used to absorb losses first. In addition, payments to debt holders (interest) are tax deductible while payments to equity holders (dividends) are not. Although design decisions have yet to be made regarding LAC, we expect internal LAC and Tier 2 capital to impose similar costs on deposit takers.

Overall, this means that capital requirements with higher proportions of CET1 capital can be far more expensive than those with greater reliance on lower quality capital like Tier 2 or LAC.

Total amount of capital

The greater amount of capital that a deposit taker is required to have the greater dollar amount of returns that are expected to be paid out by the deposit taker. However, when deposit takers are funded with a greater amount of capital, the risk to investors decreases, requiring a lower rate of return to compensate for that lower risk. Therefore, higher capital requirements can have two opposite effects on total funding costs:

- a higher amount of capital can add to funding costs as capital tends to be more expensive than debt; and
- a higher amount of capital will reduce funding costs since the required return on capital and debt will fall as risk is lower.

Of particular interest throughout the 2019 Capital Review was the extent to which equity and debt investors are willing to accept a lower rate of return if a deposit taker has more capital. The Modigliani-Miller (**MM**) theorems in finance suggest that when firms are funded with more equity, the risk to investors falls, as the bank is more resilient to shocks and less likely to become insolvent and fail. Consequently, the volatility of the investors' income stream is lower, and investors' required return on equity and debt falls.

Our analysis uses the same assumptions as in the 2019 Capital Review: this is both on theoretical grounds and pragmatic grounds. Firstly, as part of our 2023 Biennial Assessment of the Capital Review we found that the costs of capital were tracking broadly in line with the 2019 estimates.¹²⁵ These estimates were reviewed in 2019 by independent experts, Dr. James Cummings and Professor David Miles.¹²⁶ Secondly, given the short and more targeted nature of this Review, wholesale changes to the methodology are likely to be difficult to confidently validate.

We assume the following reduction in required rate of return for each 1% increase in a deposit takers equity ratio (Equity / Total Assets):

- Required rate of return on equity to fall by 0.095%.
- Required rate of return on Tier 2 debt to fall by 0.164%.

¹²⁵ See Downing, R., Martel, J., & Tanuvasa, W. (2023). Biennial Assessment 2023 Monitoring Capital Review Implementation. *Reserve Bank of New Zealand Bulletin*, 87(3). <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/bulletins/2024/rbb-2024-87-03.pdf>.

¹²⁶ For details of the independent analysis see Reserve Bank of New Zealand. (2019). *Reserve Bank releases independent analysis of Capital Review*. <https://www.rbnz.govt.nz/hub/news/2019/10/reserve-bank-releases-independent-analysis-of-capital-review>.

These translate into relatively small changes in the expected rate of return on equity and debt instruments. This is equivalent to an MM effect of around one third, where complete MM would make WAFC invariant to capital requirements.

Results

Once the mix and total amount of capital is calculated, we use the expected cost of each dollar of capital instrument to calculate the average WAFC in the system.

$$WAFC = \frac{(E \times e) + (A \times a) + (T \times t) + (L \times l) + (MD \times md) + (OD \times od)}{TotalAssets}$$

Where:

- *E* is equal to the total common equity in the system, and *e* the expected return on that equity.
- *A* is equal to the total AT1 equity, and *a* the expected return on that equity.
- *T* is equal to the total Tier 2 debt, and *t* the expected return on that debt.
- *L* is equal to the total LAC debt, and *l* the expected return on that debt.
- *MD* is equal to the total (non-regulatory) marginal debt, and *md* the expected return on that debt.
- *OD* is equal to other (non-regulatory) debt and *od* the expected return on that debt.

Marginal debt includes term deposits, debt securities and other borrowing. *Other debt* is transactional and other interest rate-insensitive funding and is the cheapest funding for a deposit taker, however, it is difficult for a deposit taker to increase or decrease its supply. Therefore, it is expected that any reduction in regulatory capital will be replaced with marginal debt to ensure total lending (the asset side of the deposit taker's balance sheet) remains constant.

For simplicity, changes in financing costs are then assumed to be passed on solely through lending rates, in order to estimate the expected cost on output in New Zealand. We assume deposit takers in the long run will issue the cheapest capital allowed. However, in reality, there may be constraints to deposit takers issuing Tier 2 debt (and AT1) in the short to medium term.

Table 27: Quantities and costs of different funding components

	2025 Actuals	2028 Estimates	Option 1: No LAC	Option 2: LAC
Total amount of capital (\$bn)				
CET1	53.1	57.5	55.3	49.5
AT1	5.8	9.2	0	0
Tier 2	7.0	8.1	10.8	10.2
LAC	0	0	0	19.2

	2025 Actuals	2028 Estimates	Option 1: No LAC	Option 2: LAC
Cost of capital (%) for each \$1 of capital under each option				
Cost of equity (pre-tax)	13.36	13.29	13.33	13.42
AT1	8.65	8.65	N/A	N/A
Tier 2	5.13	4.95	5.21	5.34
LAC	5.13	4.95	5.21	5.34
Marginal debt	4.44	4.42	4.44	4.42

Overall, we expect both options should result in small reductions in deposit-taking funding costs of 6.5 and 11.3 basis points for Option 1 and Option 2, respectively. The replacement of relatively expensive AT1 with Tier 2 debt is one component driving this reduction for both options compared to the status quo.

Option 2 would reduce funding costs the most even though it has the largest total loss absorbency including LAC. Option 2 ‘trades off’ roughly \$6 billion of CET1 capital for the additional \$19 billion of LAC. The higher required returns of CET1 compared to LAC reduces Option 2 financing costs in comparison to Option 1 by an estimated 5 basis points.

Lower financing costs for deposit takers allows deposit takers to decrease lending rates, increase deposit rates or allocate more to operational and other costs, or a mix of all three. As in the 2019 CBA, when calculating the impact on potential GDP, we assume changes in funding costs will be passed on to customers through lending rate charges.

When funding costs fall, average lending rates decline and this boosts economic activity. After substantial analysis discussed in the 2019 Capital Review, a 1:1 parameter was settled on (so that a 10basis point decline in lending rates boosts economic activity by 0.1%).¹²⁷ The changes in the components of WAFC are also important for our analysis of wealth transfers discussed further down.

Table 28: Funding costs and lending rate impacts

	Current: 2025	Option 1: No LAC	Option 2: LAC
Change in funding costs (bps)	-5.8	-6.5	-11.3
Change in lending costs (bps)	-7.1	-8.0	-13.9
Annual impact on GDP (%)	-0.07	-0.08	-0.14

¹²⁷ As in 2019, a multiple of 1 is roughly equal to the median output multiple across studies referenced in Basel Committee on Banking Supervision. (2019). *The costs and benefits of bank capital – a review of the literature*. <https://www.bis.org/bcbps/publ/wp37.pdf>.

Box E: How would the changes impact borrowing costs for New Zealanders?

The following provides a simplified example on how differences in regulatory capital requirements (risk weights and financing cost changes) can translate into savings for New Zealanders with an agricultural loan or a residential mortgage.

There is currently \$63 billion worth of agriculture loans and \$379 billion of mortgage lending.¹²⁸ Tables 29 and 30 provide a stylised example of what could happen to the interest rate paid on agricultural and mortgage lending.

The figures provided are designed to support understanding of the lending rate changes, there is still a high degree of uncertainty around the impact of capital on financing costs and how these are passed on to customers. Caution should therefore be used when interpreting these figures.

For the purposes of the example, we make the following assumptions:

- For loans originated by IRB banks, we apply the 85% standardised floor test for the individual lending categories in isolation. In practice, the standardised floor applies to aggregate risk weighted assets and not individual lending categories.
- The expected Tier 1 (component D, Tables 29 and 30) and Tier 2 (component H, Tables 29 and 30) ratios include an assumed management buffer, as well as assumptions regarding the return of surplus CET1 capital to owners under both Options 1 and 2. The ratios can be interpreted as our expectation of the banking system's long run average Tier 1 and 2 ratios based on the options and assumed individual deposit takers' management buffers.
- For agricultural lending a 7.53% average current interest rate is used, as reported in the Reserve Bank's New Credit Flows survey – the simple floating average interest for medium-sized agricultural lending. The rate is similar to that reported by Federated Farmers, through their Banking survey (of 7.59%). For residential mortgage lending a 5.66% current interest rate is used as reported as the monthly yield on residential mortgage loans. These base rates are then adjusted based on the change in total cost (component Q, Tables 29 and 30) to provide an example of the agriculture and mortgage rates that New Zealanders may face.

These stylised examples show the expected lower funding costs from Options 1 and 2, as compared to the status quo, should benefit lending categories with higher risk weights relatively more than those with lower risk weights. Higher risk lending is more sensitive to funding costs because a greater amount of capital is required for each dollar of lending.

The lower funding costs could reduce interest rates on agricultural lending by approximately 20 basis points as compared to the 2019 policy settings and approximately 5 basis points for the relatively lower risk residential mortgage category.

128 For data on lending by banks and non-bank lending institutions in New Zealand see Reserve Bank of New Zealand. (2025). *Registered banks and non-bank lending institutions: Sector lending (C5)*. <https://www.rbnz.govt.nz/statistics/series/lending-and-monetary/registered-banks-and-non-bank-lending-institutions-sector-lending>.

The example takes into account the lower risk weights on agricultural and residential mortgage lending as proposed in Section 5.2.

Table 29: Impact of changes on agricultural lending

	Lending and costs	Formula	Current: 2025	Status quo: 2019 Capital Review settings	Option 1: Non-LAC	Option 2: LAC
Agriculture lending exposure	Agri lending total (\$m)	A	62,673	62,673	62,673	62,673
	Average risk weight on agri lending	B	84.1%	84.1%	74.4%	74.4%
	RWA from agri lending (\$m)	C	52,716	52,716	46,657	46,657
Tier 1 cost	Expected Tier 1 ratio (including management buffer)	D	14.78%	16.74%	14.72%	13.17%
	Required Tier 1 for agri lending (\$m)	$C \times D = E$	7,792	8,823	6,868	6,144
	Expected cost of Tier 1 capital	F	12.57%	12.60%	13.33%	13.42%
	Cost of Tier 1 capital for agri lending (\$m)	$E \times F = G$	979	1111	915	825
Tier 2 and LAC cost	Expected Tier 2 + LAC ratio (incl. management buffer)	H	1.76%	2.04%	2.86%	7.82%
	Required Tier 2 + LAC for agri lending (\$m)	$C \times H = I$	930	1,074	1,336	3,647
	Expected cost of Tier 2 + LAC capital	J	5.13%	4.95%	5.21%	5.34%

	Cost of Tier 2 + LAC for agri lending (\$m)	$I \times J = K$	48	53	70	195
Other financing debt	Required 'other debt' to fund agri lending	$A - E - I = L$	53,526	52,293	54,855	53,343
	Expected cost of 'other debt'	M	3.49%	3.47%	3.49%	3.46%
	Cost of 'other debt' for agri lending	$L \times M = N$	1,885	1,832	1,903	1,830
Totals	Total cost to fund agri lending	$G + K + N = O$	2,912	2,996	2,888	2,849
	Percentage cost of agri lending	$O / A = P$	4.65%	4.78%	4.61%	4.55%
Interest rate impacts	Current interest rate on agri lending	$\Delta P + 7.53\% = Q$	7.53%	7.66%	7.49%	7.43%
	Lending rate benefit (compared to 2019 Capital Review decisions)		-0.13%		-0.17%	-0.23%

Table 30: Impact of changes on residential mortgage lending (RML)

	Lending and costs	Formula	Current: 2025	Status quo: 2019 Capital Review settings	Option 1: Non-LAC	Option 2: LAC
RML exposure	RML lending total (\$m)	A	366,575	366,575	366,575	366,575
	Average Risk Weight on RML	B	33.1%	33.1%	30.6%	30.6%
	RWA from RML (\$m)	C	121,230	121,230	112,156	112,156
Tier 1 cost	Expected Tier 1 ratio (incl.	D	14.78%	16.74%	14.72%	13.17%

	Management buffer)					
	Required Tier 1 for RML (\$m)	$C \times D = E$	17,919	20,291	16,510	14,769
	Expected cost of Tier 1 capital	F	12.57%	12.60%	13.33%	13.42%
	Cost of Tier 1 capital for RML (\$m)	$E \times F = G$	2,252	2,556	2,200	1,983
Tier 2 and LAC cost	Expected Tier 2 + LAC ratio (incl. Management buffer)	H	1.76%	2.04%	2.86%	7.82%
	Required Tier 2 + LAC for RML (\$m)	$C \times H = I$	2,138	2,471	3,211	8,767
	Expected cost of Tier 2 + LAC capital	J	5.13%	4.95%	5.21%	5.34%
	Cost of Tier 2 + LAC for RML (\$m)	$I \times J = K$	110	122	167	469
Other financing debt	Required Other debt to fund RML	$A - E - I = L$	346,518	343,814	346,854	343,039
	Expected cost of 'Other debt'	M	3.49%	3.47%	3.49%	3.46%
	Cost of Other debt for RML	$L \times M = N$	12,106	11,932	12,117	11,869
Totals	Total cost to fund RML	$G + K + N = O$	14,468	14,611	14,484	14,320
	Percentage cost of RML	$O / A = P$	3.95%	3.99%	3.95%	3.91%
Interest rate impacts	Current interest rate on RML	$\Delta P + 5.66\% = Q$	5.66%	5.70%	5.66%	5.62%
	Lending rate benefit (compared to 2019 Capital Review decisions)		-0.04%		-0.03%	-0.08%

Part 2: Cost of crisis

The overall model replicates the framework used in the 2019 Capital Review, specifically the concept of change in 'expected GDP', by quantifying the probability and extent of potential credit losses using an 'Asymptotic single factor risk model' (ASFR).¹²⁹

The ASRF is a simplified credit risk model that is used in Internal Ratings-Based (IRB) models and that underpins the international Basel capital framework. Here it has been inverted so it takes a capital level and computes the probability of depleting it. A larger amount of capital reduces the probability that any crisis event would exhaust all capital in the system. The probability of crisis is then multiplied by the expected cost of a crisis.

$$\text{Change in expected GDP} = \text{Probability of crisis} \times \text{Cost of crisis}$$

The cost of crisis calculation used in this Review (as well as the 2019 Capital Review) has four key inputs; these are defined in Table 31:

- Probability of default (PD)
- Loss given default (LGD)
- Capital (expressed as a proportion of EAD)
- Asset Correlation (R)

For this Review we use the same assumed PD, LGD and R as in 2019. The risk landscape, as explored in Section 2.2, on a net basis has not materially changed to the point that we can justify changes to these figures. Capital, expressed as a proportion of EAD, is adjusted depending on the capital in each option.

Similarly, for the cost of crisis, we continue to use the assumption that a crisis would result in lost economic output of 63% of GDP. We assume that a 'crisis' only arises when all capital (including LAC, if present) is consumed by losses. These large costs are in part due to the permanent effects that financial crises can have on the growth trajectory of modern economies. Due to the size and interconnectedness of the four large banks in New Zealand events that result in the loss of all capital for one, or more, of those deposit takers may trigger a crisis event, as defined.

Along with updating the capital amount based on the capital requirement options proposed, we have sought to make minor improvements to the 2019 model. The improvements are designed to improve the comparability of the options, thereby improving relativity. The model still remains highly dependent on a small number of inputs. The primary amendments are that:

- Group 2 capital requirements have been included in the model and given a weight of 10%. Group 1 requirements are given the remaining 90% weight.
- A new 'LAC trigger event' has been introduced.

¹²⁹ For a summary of the ASRF model used, previously referred to as the 'Tuatara Model', see Reserve Bank of New Zealand. (2019). *Capital Review Background Paper: An outline of the analysis supporting the risk appetite framework*. <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/banks/review-capital-adequacy-framework-for-registered-banks/capital-review-an-outline-of-the-analysis-supporting-the-risk-appetite-framework.pdf>.

LAC trigger event

For the purposes of our estimates a LAC trigger event is defined as an event in which internal LAC is triggered for the Group 1 bank/s and the LAC is sufficient to restore solvency. The trigger point is set at when all common equity is absorbed by losses.

Relying on international literature on the costs of orderly crises,¹³⁰ we expect a successful LAC event would avoid the majority (approximately three-fifths) of the expected loss of a crisis event. However, we still expect an event of this magnitude would have a large impact on the New Zealand economy, resulting from a deterioration in confidence in the financial system leading to lower lending and borrowing and overall misallocation of capital in the economy. In line with BCBS estimates of the costs of an orderly crisis we reach a similar estimate of 20% (present value of fall in GDP) cost on New Zealand if a LAC trigger event came to fruition.

The introduction of a 'LAC trigger event' results in the following high-level formula:

$$\text{Change in expected GDP} = (\text{Probability of crisis} \times \text{Cost of crisis}) + (\text{Probability of LAC event} \times \text{Cost of LAC trigger Event})$$

The cost of a crisis event in our central estimate is set at 63% of GDP, and the cost of a LAC trigger event is set at 20% of GDP. Scenario analysis is completed on these figures.

Table 31: Expected cost of crisis

Options	Cost of crisis (% of GDP)
Status quo: 2019 Capital Settings	0.32
Option 1: No LAC	0.56
Option 2: LAC	0.45

For example, the status quo cost of crisis of 0.32% of GDP is calculated by multiplying the probability of crisis (roughly 1-in-200, estimated based on the status quo's capital requirements) by the assumed expected cost of a crisis (63%).

The probability for a bank failure event (either a crisis or a LAC trigger event) is much higher within Option 2 as compared to the status quo and non-LAC option. However, the cost of such an event would be expected to be lower because LAC events are milder.

Scenario analysis

The costs and nature of financial crises have historically varied considerably and therefore reasonable estimates of the cost of future crises can vary. In addition, New Zealand has little modern experience of severe banking crises.

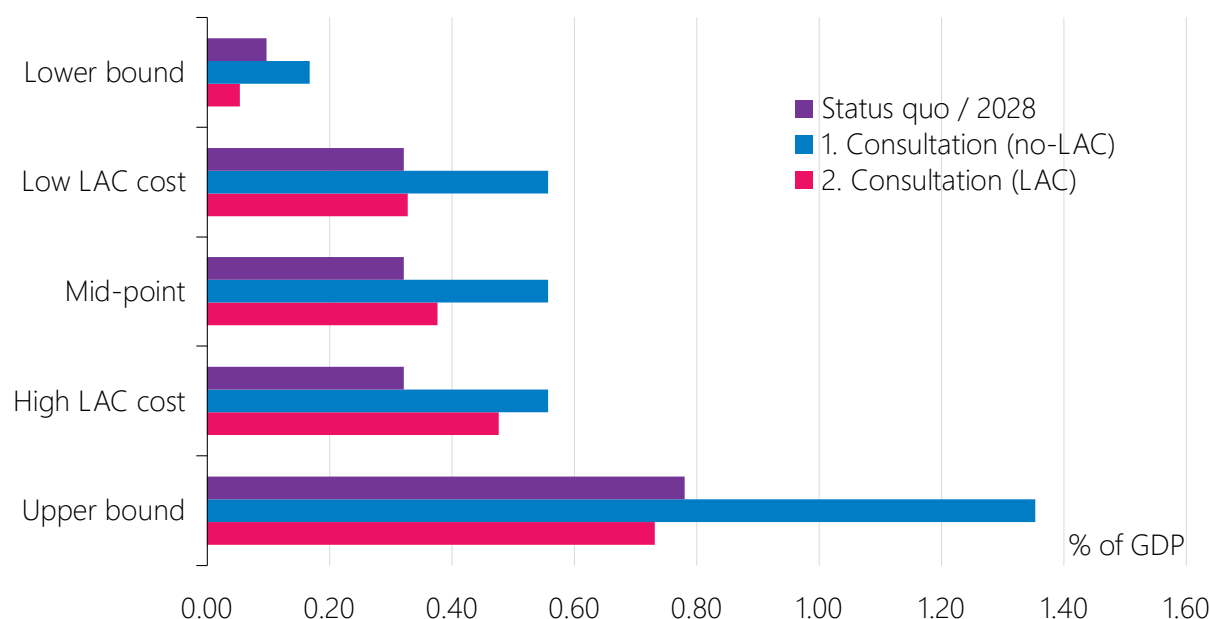
¹³⁰ The Bank of England's assumption that orderly bail-in reduces cost of crisis by 60%, in addition to having other benefits. See Bank of England. (2015). *Measuring the macroeconomic costs and benefits of higher UK bank capital requirements*. <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-paper/2015/measuring-the-macroeconomic-costs-and-benefits-of>

The central estimate of 63% used is guided by empirical results but still includes judgement.¹³¹ As outlined in 2019, estimates of the costs of crises explored at that point varied from 19% to 153%. These bounds have again been used to help analyse the options proposed in the paper. In addition to these lower and upper bounds for the cost of crisis, we have included scenarios where the costs of LAC events vary. Due to the novelty of internal LAC in New Zealand, Scenarios 2 and 4 are designed to focus on the costs of LAC trigger events. The ranges analysed in Table 32 and Figure 25 are wider than those provided previously in the main body of this Consultation Paper and are designed to illustrate the expected lower and upper bounds of the costs of crises.

Table 32: Range of cost of crisis and LAC trigger events

	Lower bound	Low LAC cost	Mid-point	High LAC cost	Upper bound
Cost of crisis (%)	19	63	63	63	153
Cost of LAC trigger event (%)	0	15	20	30	30

Figure 25: Expected cost of bank failures



Source: RBNZ estimates.

In all scenarios, we estimate that Option 1 increases the expected cost of bank failures, compared to the status quo. The difference in expected cost of bank failures between Option 2 and the status quo is dependent on the expected cost of a LAC event.

¹³¹ This aligns to BCBS estimates of the costs of an orderly crisis which was used as a lower bound in the 2019 analysis. See Basel Committee on Banking Supervision. (2010). *As assessment of the long-term economic impact of stronger capital and liquidity requirements*. <https://www.bis.org/publ/bcbs173.pdf>. The Bank of England's assumption is that orderly bail-in reduces cost of crisis by 60%, in addition to having other benefits. See Brooke, M., Bush, O., Edwards, R., Ellis, J., Francis, B., Harimohan, R., Neiss, Katharine., & Siegart, C. (2015). Measuring the macroeconomic costs and benefits of higher UK bank capital requirements. *Bank of England Financial Stability Paper*, 35. <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-paper/2015/measuring-the-macroeconomic-costs-and-benefits-of>.

Part 3: Transfer of wealth

In addition to the primary output costs and benefits from capital we have included the benefits of lower transfers from New Zealand borrowers to overseas owners.

In general, transfers between groups are neither a net cost nor net benefit, unless there is a good reason that the benefit to one group outweighs the cost to the other. However, the Treasury in their "Guide to Social Cost Benefit Analysis"¹³² highlight that benefits that accrue to people outside of New Zealand are generally ignored. In the case of transfers from New Zealand borrowers (and lenders) to deposit takers, and ultimately to owners of deposit takers the cost is incurred by New Zealand, but the majority of the corresponding benefit is received by overseas persons.

As in 2019, to recognise the incidence of the costs and benefits, an adjustment is made to recognise the expected change in interest costs paid by borrowers that accrues to overseas owners. This is measured by:

- Multiplying the change in interest paid by borrowers by the overseas ownership share of New Zealand deposit takers.

Table 33: Transfer of wealth effects

	1. Consultation: no LAC	2. Consultation: LAC
Direct savings from lower interest payments (%)	0.09	0.16
Lower tax on interest payments (%)	0.03	0.04
Net wealth transfer cost (%)	0.07	0.11

Adjusting for tax

An offsetting impact on the savings to New Zealand from lower interest payments from borrowers to offshore deposit takers is the lower tax paid on that income.

To take the lower tax received on these payments into account the change in interest payment income is multiplied by the statutory tax rate. This partially offsets the benefit of the lower interest payments.

¹³² The Treasury. (2015). *Guide to Social Cost Benefit Analysis*. <https://www.treasury.govt.nz/publications/guide/guide-social-cost-benefit-analysis>